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12th edition

Securitisation in Luxembourg

A comprehensive guide

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Preface

We are happy to present to you the 12th edition of our brochure “Securitisation in Luxembourg - A comprehensive guide” as part of our series of publications related to securitisation in Luxembourg. We would like to thank you for your comments and suggestions over the last years, making this publication the preferred reference guide for securitisation in Luxembourg.

We have restructured some parts to provide a better overview of the relevant items.

In “Chapter 3 – The Luxembourg Securitisation Law”, the amendments of the modernised Luxembourg Securitisation Law are now fully integrated into the subchapters. In order to reflect their relative importance, the former chapters 4-6 have been renamed and reordered based on the different aspects presented. Hence, you will find dedicated chapters for accounting, taxation, regulatory, governance and other aspects.

Especially taxation deserved its own chapters as more and more European and global rules are published in this regard. The Anti-Tax Avoidance Directive 1 (ATAD 1) is still an intensively discussed topic in various working groups of Luxembourg industry associations. Even if most of the securitisation structures are not significantly impacted by the interest limitation rules and solutions are in place for other structures, our recently published market survey pointed out that the uncertainty about the interpretation of the ATAD 1 interest limitation rules remain the main challenge for arrangers and investors to set-up – or keep – their securitisation vehicles in Luxembourg. For more details, please see the new chapter 5.

In 2022, with around 170 new Luxembourg securitisation vehicles, the total number grew again. By the end of March 2022 around 1,485 vehicles, presumably representing more than 6,000 compartments, existed in Luxembourg. We expect this growth to continue in the next few years because we see some arrangers using new features of the modernised law, like 100% loan financing or partnerships as legal forms. The number of supervised securitisation vehicles remained stable representing around 2% of the Luxembourg securitisation vehicles but the volume decreased by 14% to EUR 40,7 billion by the end of 2022.

As in previous years, we have chosen to publish our brochure in an electronic version to facilitate its accessibility and to stay in line with our corporate objective of minimising our carbon footprint. However, if you would like to receive a hardcopy, please let us know.

We hope that you will enjoy reading the 2023 update of our brochure and that it will provide you with valuable insights into the securitisation market and related best practices in Luxembourg.

Last but not least I would like to thank everyone that contributed to the update of the brochure for their time and efforts. This publication could not be realised without our team of dedicated securitisation professionals who are happy to assist you in any of your securitisation questions.

Holger von Keutz
Securitisation Leader

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Securitisation market and trends

1.1 Recent developments

The world does not stop to be in a crisis mode - unfortunately we started the brochure with this sentence last year and it remains to be true. After the coronavirus pandemic (Covid-19), we are now facing a lasting war between Russia and Ukraine. This now also hits the economic and financial world with increased inflation which all of us, including securitisation transactions, need to cope with. In such an uncertain situation, it remains impossible to forecast what will happen in the next months, including the impact to the financial markets and for securitisation. Nevertheless, we remain optimistic that even given these circumstances securitisation will remain a demanded and flexible tool of financing.

The second half of 2022 was rather calm with regards to ground-breaking developments in securitisation. The EU Securitisation Regulation and the sub-group of simple, transparent and standardised securitisations ("STS") is now well established, both in Luxembourg and Europe. Changes already occurred to this Regulation, Brexit brought United Kingdom parties out of scope and further proposals for improvement have been made to the European Commission. In Luxembourg, the long-awaited modernisation of the Luxembourg Securitisation Law has been voted on 9 February 2022 (in force since 8 March 2022). It is not a revolution but a necessary evolution. The Luxembourg Securitisation Law was successful for almost 20 years and the modernised law builds on this with adding new features, most importantly yet not exclusively: (i) extending refinancing to "financial instruments" (incl. allowing 100% loan financing) instead of limiting to securities, (ii) allowing for active management of a portfolio of debt instruments and (iii) allowing the set up of a securitisation vehicle in the form of a partnership. Those modifications shall bring an even higher flexibility and increased legal certainty to securitisation transactions established in Luxembourg also as compared to other jurisdictions. We could already observe some of these features being used in the Luxembourg securitisation market, while the majority remains "standard" securitisations as we knew them from the past.

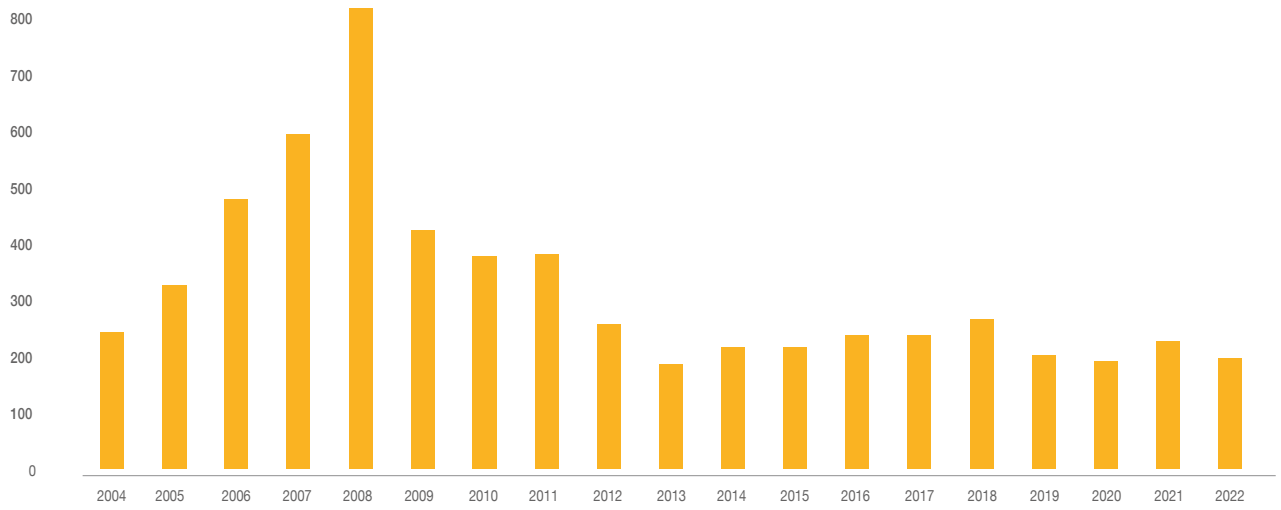
The other important topic, still intensively discussed since 2019 between the Luxembourg market participants, is the impacts of the EU directives on anti-tax avoidance. Luxembourg securitisation companies are not per se excluded and theoretically impacted by these tax regulations, especially by the introduction of provisions in the tax law that limits the deduction of (net) interest and similar expenses for Luxembourg taxpayers. There are still ongoing discussions between the Luxembourg market participants on the actual impact for the different types of structures as the rules are understood differently amongst them. In this respect, the administrative circular 168bis/1 first released on 8 January 2021 by the Luxembourg tax authorities and several times amended provided a few clarifications amongst the multiple questions raised by the market with respect to the interpretation of the interest limitations rules. Yet, some specific structures and interpretations remain untackled by the amended circular. On 22 December 2021, the European Commission released a draft ATAD 3 that aims to prevent the misuse of shell entities for tax purposes that could limit the tax benefit claimed by securitisation companies as from 2024. On top of that, EU member states also approved a new directive on 25 November 2022 that aims to ensure a global minimum level of taxation for multinationals enterprises groups and large-sale domestic groups in the European Union that could impact some securitisation vehicles.

1.2 European market overview

The development of the securitisation market in Europe can be analysed from two different angles: either taking into account transactions with the issuing vehicle domiciled in Europe, or looking at those with European collateral/underlying investment. For the former, we refer to the statistics published by the European Central Bank ("ECB") for the Euro area and discuss this further in the next section. An analysis of the European market by collateral country and type is performed by the Association for Financial Markets in Europe ("AFME") in cooperation with the Securities Industry and Financial Markets Association ("SIFMA") on a quarterly basis and is presented hereafter.

The graph in Figure 1 illustrates that the yearly issuance volume in Europe was cut in half in the wake of the financial crisis in 2008. After further decline in subsequent years, the European securitisation issuances have finally stabilised since 2014, with the strongest year since then in 2018. After smaller issuance volumes in 2019 and 2020, 2021 was very strong with around EUR 233 billion of new issuances. In 2022, issuances stabilised again with just about EUR 203 billion.

Figure 1: European securitisation issuance (in billion EUR)



Source: AFME Securitisation Data Reports

Total outstanding volume (excl. CLO) in Europe has decreased to EUR 937 billion by the end of 2022 (2021: EUR 1,010 billion), while the US market continued to be more than ten times bigger than the European market. Most of the collateral of European securitisations remain located in the UK, followed by Spain, Italy and the Netherlands.

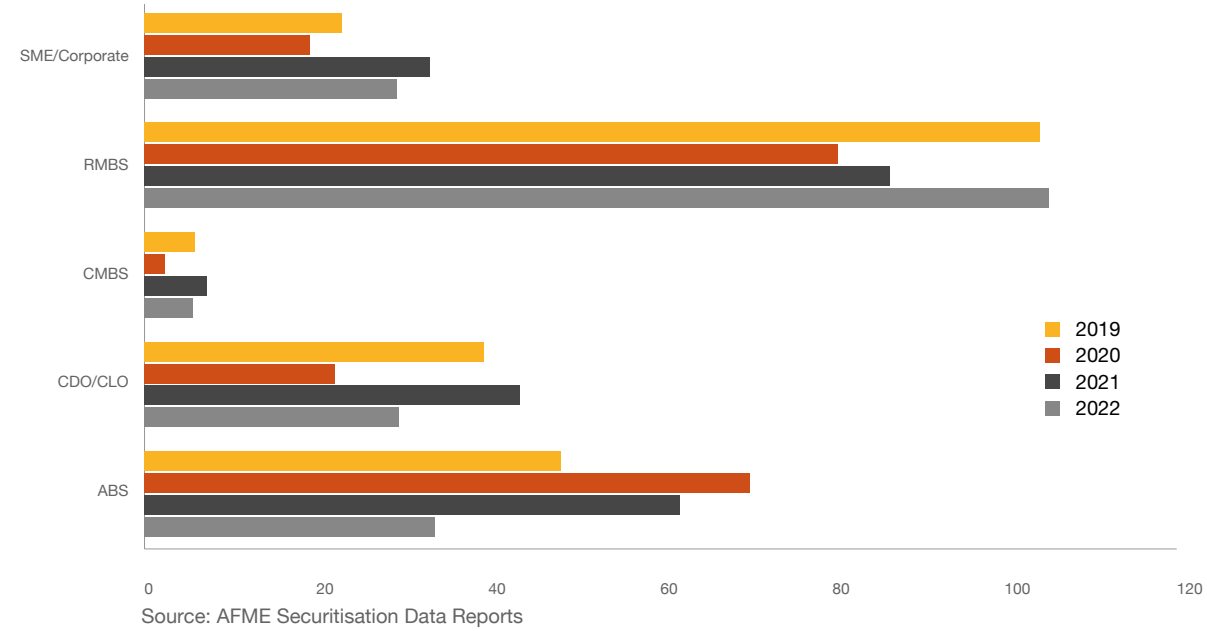
With regards to the type of underlying assets, and as illustrated in Figure 2, residential mortgage loans represent more than half of the collateral type for securitisation issuances (so-called Residential Mortgage Backed Securities ("RMBS") in 2022 with 52% of the total EUR 203.3 billion of new issuances (2021: 37%). They are followed with 17%

(2021: 27%) by other Asset-Backed Securities (“ABS”) including asset types like consumer loans, credit card receivables, other leases together with the securitisation of whole businesses (“WBS”). Collateralised Debt or Loan Obligations (“CDO/CLO”) issuance volumes have stabilised in absolute and relative figures to 15% (2021: 19%). Next in line is financing of small and medium sized entities (“SME”) which made up for around 14% again (2021: 14%) while, as in the past, Commercial Mortgage-Backed Securities (“CMBS”) stayed with 3% relatively insignificant in Europe (2021: 3%).

The total outstanding European securitisations (as compared to new issuances described above) remain dominated by RMBS making up more than half of the volume. Other ABS (incl. auto and consumer loans) transactions rank far behind making up circa one third together.

The above figures show us that European securitisation seems to have stabilised since the financial crisis but still on a relatively low level compared to the US. One reason may be a different maturity of the respective capital markets, with European financing of the economy still largely dependent on bank loans. Another reason is the active role that the government-sponsored agencies play in the US with no equivalent in the EU. The European Commission has recognised this, and intends to foster the growth and integration of European capital markets with its Capital Markets Union initiative. Securitisation has been identified as one of the tools to achieve this union and growth for the real economy, also and especially for the Covid-19 recovery plans. The impact of the Russian war against Ukraine and the related sanctions against Russia as well as the increased inflation on the securitisation markets needs to be further observed.

Figure 2: European securitisation issuance by collateral type (in billion EUR)



Source: AFME Securitisation Data Reports

1.3 Luxembourg market overview

Development of the Luxembourg securitisation market

Despite the difficult global economic situation, the Luxembourg securitisation market continues to show a positive trend with almost 2,750 securitisation vehicles (companies and funds) in total created since the adoption of the Luxembourg Securitisation Law in 2004. Around 1,450 of them existed as at the end of 2022 (2021: 1,377). This proves once again that Luxembourg remains a prime location for securitisation transactions in Europe. After a net decrease of the number of securitisation vehicles in 2019, we have observed a net increase in 2020 and 2021 with a stabilisation in 2022.

Our figures are based on an in-depth research of the Luxembourg official journal ("Mémorial"), the company list published by the Luxembourg trade register ("Recueil électronique des sociétés et associations" or "RESA"), the ECB reporting on Financial Vehicle Corporations ("FVC") and other sources. As such, it remains an estimation and not an exact science, even though we thrive to make our list as complete as possible. During our regular quality checks, we may also have to adjust historical figures.

Our research goes further than the statistics of the ECB, which are sometimes used to quantify the Luxembourg securitisation market, since we focus on Luxembourg undertakings incorporated under the Luxembourg Securitisation Law regardless of their size. In fact, the FVC reporting of the ECB does not include each Luxembourg securitisation undertaking, and some Luxembourg FVC are not subject to the Luxembourg Securitisation Law. This is due to the different definitions and reporting thresholds: e.g. an FVC is any entity that carries out securitisation transactions and issues securities (which does not have to be under the Luxembourg Securitisation Law); on the other hand, even though each Luxembourg Securitisation vehicle shall be deemed FVC (as per the interpretation of the Banque Centrale du Luxembourg ("BCL")), not all would be included in the regular reporting having a reporting threshold of EUR 70.0 million.

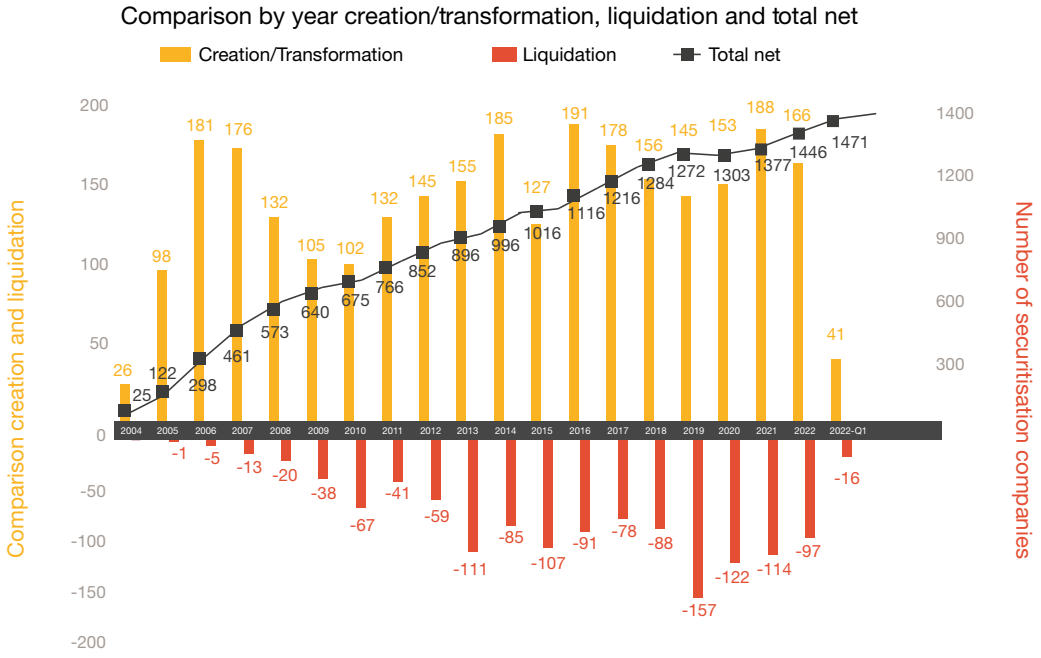
We have illustrated the development over time in Figure 3 which shows 1,449 active securitisation undertakings at the end of 2022 (2021: 1,377). The gross number of creations slightly decreased in 2022 to 166 (2021: 188) which was also the trend for liquidations with only 97 liquidations in 2022 (2021: 114), making last year net positive again. The number of creations in 2022 was less than in 2021, mostly due to the huge decrease of creations during Q4 of 2022, with only 16 creations in comparison to 52 in 2021 during the same quarter.

We have also been able to break down our analysis by type of entity (securitisation company, fund and management company). We assume to have around 87 securitisation management companies active in Luxembourg (2021: 69), which are managing a total number of around 94 securitisation funds (2021: 75). This would mean that still only around 6% of the undertakings under the Luxembourg Securitisation Law are set up as funds. However, in 2022 securitisation funds made up around 13% of all new creations - to be observed if this constitutes a new trend. We would also expect some new securitisation vehicles to be created under the partnership and corporate forms now newly allowed under the modernised Securitisation Law (see Chapter 3).

Regarding the corporate securitisation vehicles, the majority, 50%, of the active vehicles at the end of 2022 are created in the form of a SARL (2021: 51%), followed by SA 40% (2021: 45%). The trend that the majority of newly created securitisation companies are formed as SARL started in 2017 leading to around 80% of the new creations being SARL in 2022. We believe this is due to the reform of the Luxembourg Law of 10 August 1915 on commercial companies (the "Commercial Law"), which permits public bond issuances of SARL since mid-2016.

As already highlighted in the past, the number of securitisation undertakings itself is not representative of the extent of securitisation transactions in Luxembourg. With the specificity of the Luxembourg Securitisation Law allowing for the creation of compartments (ring-fenced sub-divisions of the securitisation undertaking) it is easily, quickly, and cost-efficiently possible to have several securitisation transactions within one legal entity. In our PwC Market Survey published in April 2023, Luxembourg market participants have confirmed that the vast majority (>90%) of the observed vehicles have multiple compartments. We estimate that between 6,000 and 8,000 transactions are executed in the currently active securitisation undertakings.

Figure 3: Yearly evolution of Luxembourg securitisation vehicles



Source: PwC Analysis based on Luxembourg trade register, ECB statistics and CSSF figures

It is also worth mentioning that Luxembourg offers special investor protection for undertakings issuing securities to the public on a continuous basis. Such undertakings need to be supervised by the Commission de Surveillance du Secteur Financier ("CSSF"). As of 31 December 2022, a reduced number of 29 (2021: 28) (one additional entity was withdrawn in January 2023) undertakings are supervised and have around EUR 40,7 billion securitised assets (2021: 47.6 billion), i.e. a decrease of around 14% or EUR 6.9 billion. In addition, there are EUR 1,5 billion securitised in fiduciary estates and shown off-balance. It is interesting to see that those supervised entities make up only around 2.0% (2021: 2.0%) of the FVC registered in Luxembourg, but represent around 10% (2021: 14%) of the total assets. The supervised securitisation companies have mostly created several compartments in order to issue certificates as investment products for retail investors (so called "structured products", paying the performance of an index or similar underlying synthetically received via a total return swap.

Luxembourg's position in Europe

A look at the ECB statistics for international comparison (Euro area), clearly confirms that Luxembourg remains one of the leading centres for securitisation and structured finance vehicles. In fact, 1,459 FVCs or 28.2% of all Euro area FVCs were incorporated in Luxembourg (2021: 1,403 or 28.9%%). For the second year in a row, Luxembourg is behind Ireland (2022: 1,621 or 31.3%; 2021: 1,496 or 30.8%). Italy is ranked third with significantly less FVCs incorporated (2022: 930 or 18.0%; 2021: 861 or 17.7%) but still almost double the number of the fourth (see Figures 4 and 5).

With regards to the amount of securitised assets, Luxembourg ranked again third after Ireland and Italy. Furthermore, the FVC statistics offer insights on the number of "series" of securities issued, which can be seen as an approximation for the number of transactions, compartments or silos within the entities. With 6,415 "series" (2021: 6,200), Luxembourg lost its leading position to Ireland with 9,869 "series". However, we could see in the past years that for both Luxembourg and Ireland these figures are fluctuating between 6,000 and 9,000. It should also be noted that

Figure 4: Euro area countries for securitisation

	Number of FVC		"Series"		Total Assets (in billion EUR)	
	2022	2021	2022	2021	2022	2021
Grand Total	5,174	4,860	30,277	20,592	2,252	2,229
Luxembourg	1,459	1,403	6,415	6,200	395	381
Ireland	1,621	1,496	9,869	9,236	603	583
Italy	930	861	3,206	2,942	492	475
France	465	446	638	613	300	276
Netherlands	279	274	320	303	173	217
Spain	254	271	809	823	152	168
Latvia	51	1	8,491	1	-	-
Other	115	108	529	474	137	129

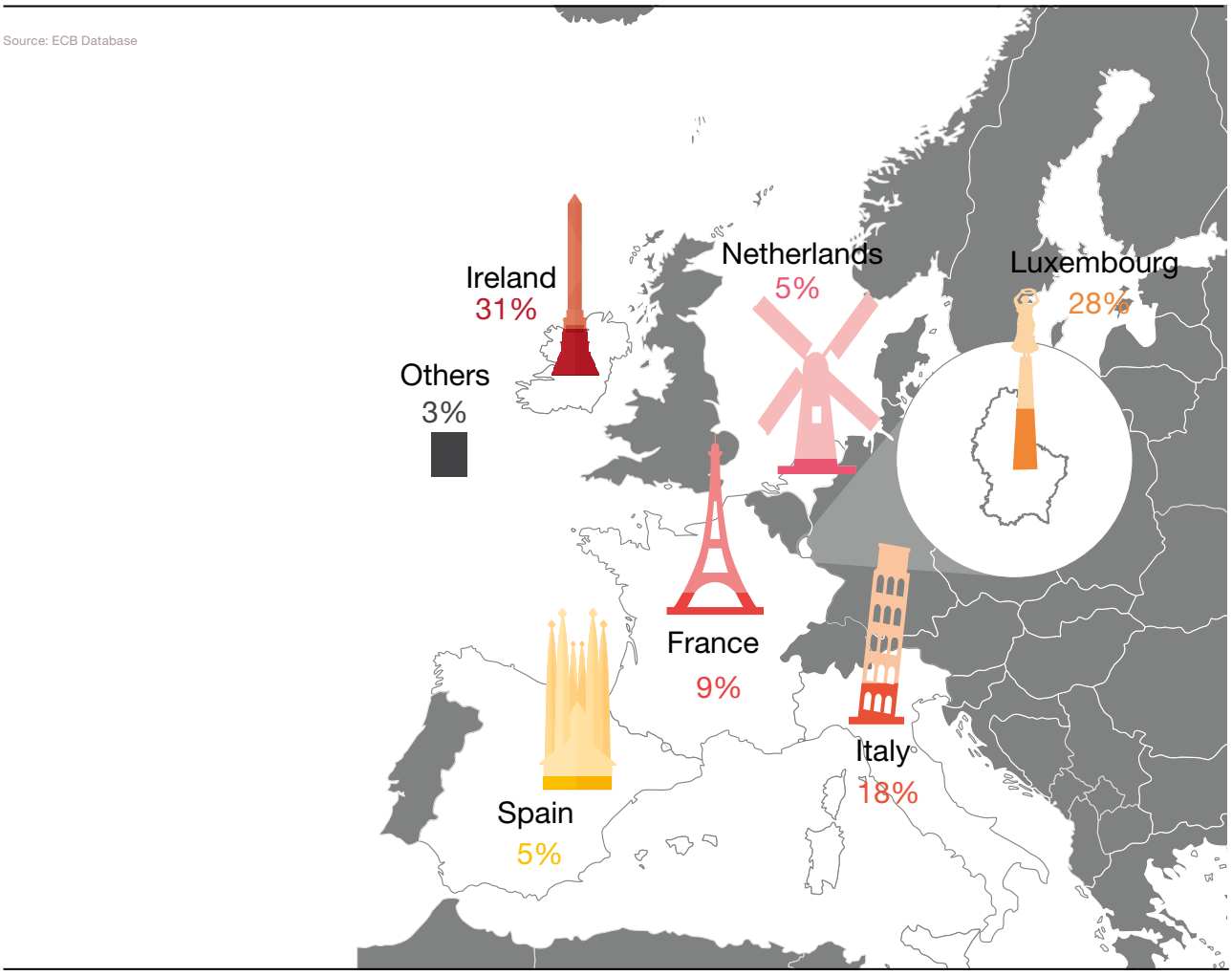
these historic figures are regularly restated by the ECB and the numbers or rankings may change retrospectively. A complete overview of the Euro countries for securitisation in the Euro area can be found in Figure 4. Obviously, these statistics for the Euro area do not include the UK, which is also one of the major players in the European securitisation market.

Asset types and financing in Luxembourg and Europe

When looking closer at the top three Euro area securitisation countries, the ECB statistics allow for a closer look into asset types (high level) and ways of financing. Luxembourg FVCs securitise mainly loans (37%, 2021: 39%) and debt securities (37%, 2021: 34%), but a significant portion is also invested in equity and funds (13%, 2021: 14%). Irish and Italian FVCs are also mainly investing in loans and debt securities (Ireland: 71%; Italy: 80%) while only a minority holds funds or other equity interests (Ireland: 5%; Italy: 0%) which is almost unchanged to prior year.

Figure 5: Market share of FVCs per country (in Euro area, as at 31 December 2022)

Source: ECB Database



On the financing side, the statistics show that, as in prior year, the vast majority of Luxembourgish and Irish FVCs are financed by the issuance of debt securities (Luxembourg: 86%; Ireland: 78%; Italy: 47%) while Italian FVCs are mainly financed by other liabilities (52%). Interestingly, only Luxembourg FVCs are partly financed by equity (Luxembourg: 3%, Ireland and Italy: 0%), probably due to the flexibility in the Luxembourg Securitisation Law and favourable tax regime. On the other hand, a significant portion of Irish vehicles are loan financed (13%), which remains relatively low for Luxembourg securitisation undertakings (Luxembourg: 5%, Italy: 1%) since loan financing was only allowed under certain conditions under the Luxembourg Securitisation Law in the past. Since the modernisation of the Luxembourg Securitisation Law, 100% loan financing is now also possible for Luxembourg vehicles.

Based on our observations and confirmed by our **PwC Market Survey** published in April 2023, the Luxembourg securitisation market's main asset classes are bonds, securities repackaged and trade and lease receivables or supply chain finance. Followed by real estate including performing mortgage loans, investment funds and structured products. Last but not least, the fifth main asset in Luxembourg is performing loans; the order slightly changed compared to 2022.

Securitisation undertakings are also regularly used as structuring alternatives or investment products for real estate or private equity groups. Insurance companies and pension funds, investment funds and banks remain the main investor groups.

Check out our latest Securitisation in Luxembourg - PwC Market Survey

Outlook

We remain confident about the further growth of the Luxembourg securitisation market. After a slower growth after the pandemic, we now observe again an increase in the creation of new securitisation vehicles.

And Luxembourg fulfils all preconditions to accommodate for further growth: (i) a proven, robust but still flexible legal environment, (ii) possibility to securitise numerous asset classes, (iii) compliance with EU securitisation requirements or remaining outside, (iv) provide a cost and time efficient framework through with compartments, (v) allow active management of debt instruments and direct lending, and, last but not least, (vi) a network of experienced service providers.

2

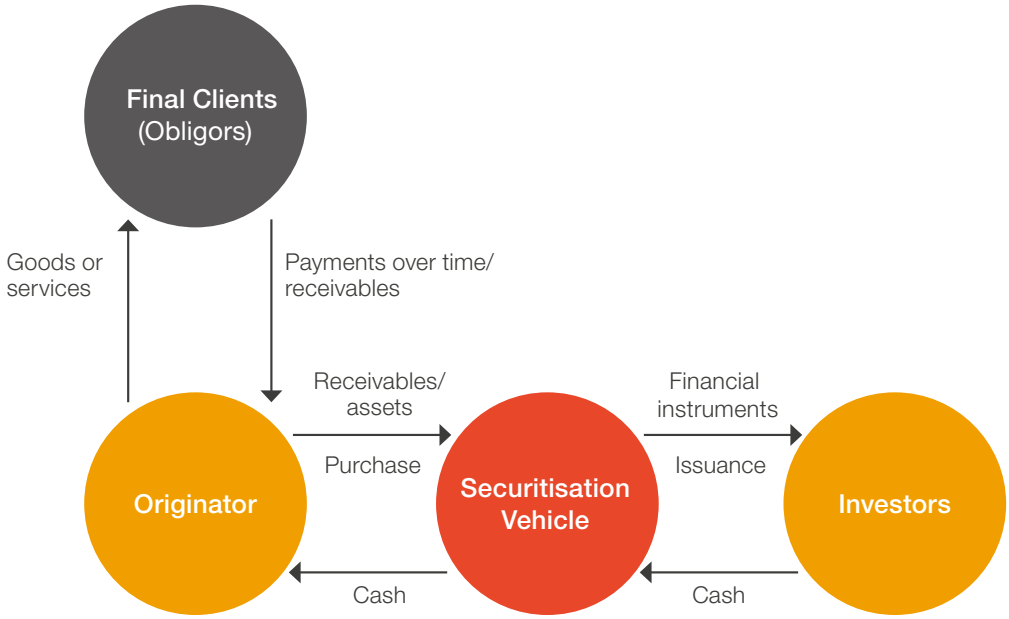
Securitisation basics

2.1 What is “securitisation”?

In a nutshell, securitisation is the pooling of various assets and the financing of the acquisition of these pooled assets by the issuance of securities or more broadly speaking of financial instruments. The first asset securitisation transactions took place in the 1970s in the form of structured financing of mortgage pools. Over the years, securitisation transactions have become a mature and significant sector of the European capital markets with transactions using several asset types as collateral (e.g. residential mortgages, debt, trains, wagons, properties, and rents) as well as auto loans, credit card receivables, and consumer loans. Nowadays, securitisation is recognised more and more as an efficient tool to provide funding to the market. In addition, structured product securitisation vehicles – synthetically transferring the performance of reference assets through derivatives – have been established in order to issue certificates for retail clients.

Broadly speaking (and illustrated in a simplified way in Figure 6), a pool of cash generating financial assets is transferred from a so-called “Originator” to a SPV or “Securitisation Vehicle” (“SV”). The SV finances the acquisition of these assets by the issuance of financial instruments, whose interest and principal payments depend on – and are backed by – the assets transferred.

Figure 6: Securitisation process



More generally, SVs may only assume a risk without the acquisition of the reference assets (transferring the performance through derivatives instead).

From an originator's perspective, the securitisation transaction:

- enables the transfer of specific ownership risks to parties who have higher capabilities to manage these risks; and
- grants access to capital markets with a potentially better debt rating than the general corporate rating of the originator.

Further benefits are described below.

The "*structuring*" process is one of the central elements of a securitisation transaction. Securitisation typically splits the credit risk into several tranches with different risk profiles. This allows the issuer to attract a wide range of investors with different risk and reward appetites. A very common allocation of tranches is 80% senior tranches with the remaining part split into other tranches, often called subordinated, mezzanine or junior tranches. The most senior tranche is usually high-rated and is protected from credit losses (up to a certain amount) by having priority on the cash flow received from the assets. The lower tranches are consequently rated lower and designed to absorb first credit losses. These tranches have higher margins to compensate for the additional risk.

The first-loss tranche (or so-called "first-loss piece") is often held by the originator and offers a high risk-and-reward profile. The most probable credit losses of a securitisation transaction are concentrated in this tranche. The first-loss tranche is usually capped at "expected" or "normal" rates of portfolio credit losses, so all credit losses up to this point are effectively absorbed by this tranche. As remuneration, the first-loss tranche typically receives the remaining portfolio cash flows after all prior claims (transaction related fees, senior principal, senior interest, etc.) have been settled, the so-called excess spread.

The payment sequence follows the structuring concept and is called a "waterfall". It shows similarities to the well-known champagne waterfall we see at weddings, with various levels of glasses balanced on one another. The champagne waterfall may be translated to securitisation as illustrated in Figure 7:

Figure 7: The "waterfall" payment sequence (example)

The waterfall shows the order of use of the cash return from the assets, which allows both interest and transaction-related fees to be paid and the repayment of the notes issued. The underlying portfolio's cash flow is used to fill or refill the requirements of the top tranche (senior tranche). The surplus cash flow then flows down to fill or refill the requirements of the second tranche (i.e. junior, mezzanine and subordinated) and so on. This process will last until the cash flow is exhausted. The first-loss tranche at the bottom will receive all residual cash flow after all prior claims have been satisfied. The residual cash flow thus represents a high rate of return if the underlying assets are performing well, and vice versa.

2.2 Types of transactions

Different criteria can be applied to distinguish between different types of securitisation transactions. The list is not exhaustive, but the following criteria should help to distinguish the different kinds of transactions and should make their purpose easier to understand.

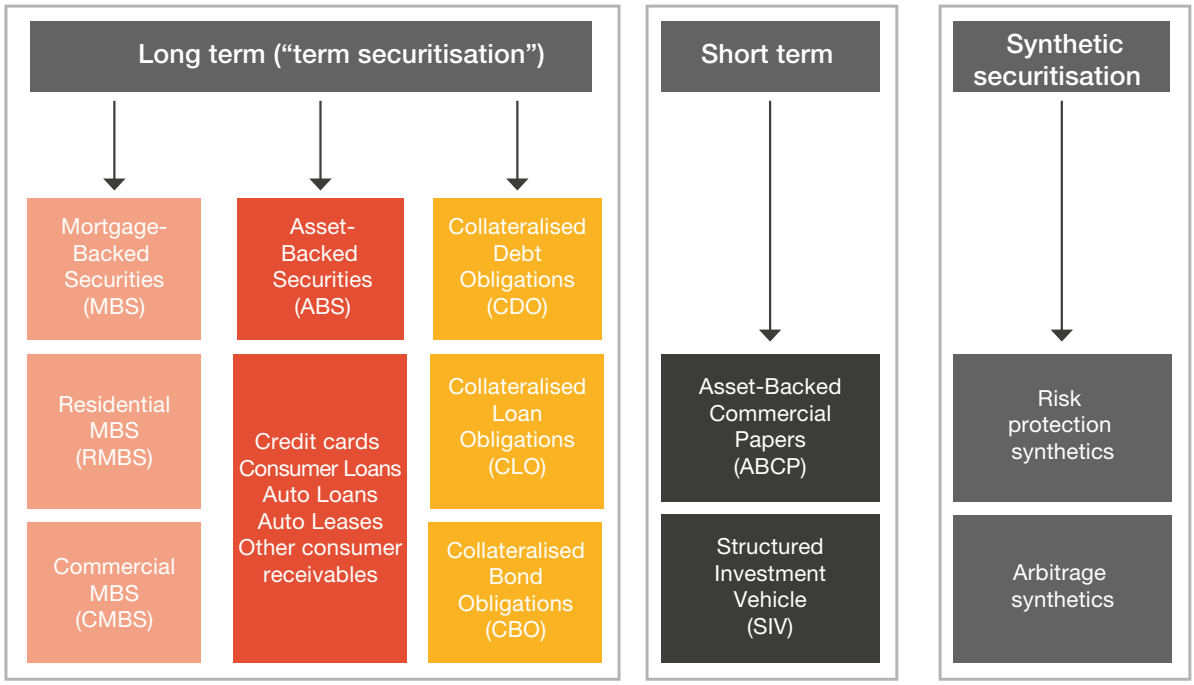
An overview is given in Figure 8.

Term securitisation vs. securitisation via Asset-Backed Commercial Paper ("ABCP")

Term securitisations are long-term placements on the capital market. When the underlying portfolio (assets or loans) is paid back, the transaction is naturally closed. Term securitisations are usually classified by asset type as outlined below.

Securitisations issued via ABCP allow for short-term financing on a roll-over basis on the money market. These transactions are regularly set up for an unlimited period. A typical example is the revolving securitisation of trade receivables. Other short term securitisations are Structured Investment Vehicles ("SIV"), refinancing long-term assets with short-term liabilities in order to gain on credit spread differences.

Figure 8: Transaction types according to maturity and underlying risk



Source: European Commission

Transactions by asset classes referring to the underlying risk

Within the securitisation market, a trisection was established to differentiate the following asset classes according to underlying risk: Mortgage-Backed Securities ("MBS"), Collateralised Debt Obligations ("CDO"), and Asset-Backed Securities ("ABS").

Mortgage-Backed Securities ("MBS") are types of asset backed securities collateralised by a pool of mortgages Securities issued by the SV are backed by the principal and interest of mortgage loans. Investors receive payments of interest and principal derived from payments which are received on the underlying mortgage loans. In addition, a differentiation between Residential MBS ("RMBS") with underlying mortgages of individuals and Commercial MBS ("CMBS") with underlying mortgage loans secured by commercial properties is common.

Collateralised Debt Obligations ("CDO") pool cash flow-generating assets, such as bonds, loans or credit derivatives. Common types of transactions are Collateralised Loan Obligations ("CLO") or Collateralised Bond Obligations ("CBO"). These transactions can be classified into static or dynamic structures. In a static structure, the entire portfolio is fixed at the closing date of the transaction. As a result, the assets are not actively replaced, irrespective of the performance of a single credit risk in the underlying portfolio. The underlying assets will only be substituted in the event of full repayments or defaults, but defaults cannot usually be replaced. In dynamic or actively managed transactions, which are more common, the asset manager can replace one or more underlying assets to decrease the credit risks or to increase the performance. This means that the assets will be exchanged and credit events may be avoided.

Other Asset-Backed Securities ("ABS") represent the residual part and also the wider range of the securitisation market, which is characterised by the heterogeneity of the underlying assets. The underlying assets of ABS transactions may vary from consumer loans, secured credit card receivables, trade receivables, and student loans to securitisation of life-insurance policies, intangibles, etc.

True-sale vs. synthetic transactions

With regard to the transfer of rights of the assets, there are two forms of securitisation transactions:

(i) True-sale transactions

A true-sale transaction is the traditional form of a securitisation. The SV acquires receivables from an originator who transfers the assets to the SV. Usually, the assets are then removed from the balance sheet of the originator. The SV finances the purchase of these assets by issuing financial instruments, which are usually rated by a rating agency. The rating reflects the fact that the SV is isolated from any credit risk of the originator and the level of credit enhancement. Therefore, the originator transfers, both the legal and beneficial interest in the assets, to the SV. As a result, the investor of the SV receives the legal and beneficial rights to the underlying assets.

(ii) Synthetic transactions

In a synthetic securitisation, the originator buys protection, for example through a series of credit derivatives, instead of selling the asset pool to the SV. Such transactions do usually not provide the originator with funding. They are typically undertaken to transfer credit risk and reduce regulatory capital requirements.

As a general rule, the owner of the assets (the "Protection Buyer") transfers the credit risk of a portfolio of assets (a "Reference Portfolio") to another entity (the "Protection Seller"). Although the credit risk of the Reference Portfolio is transferred, its actual ownership remains with the Protection Buyer.

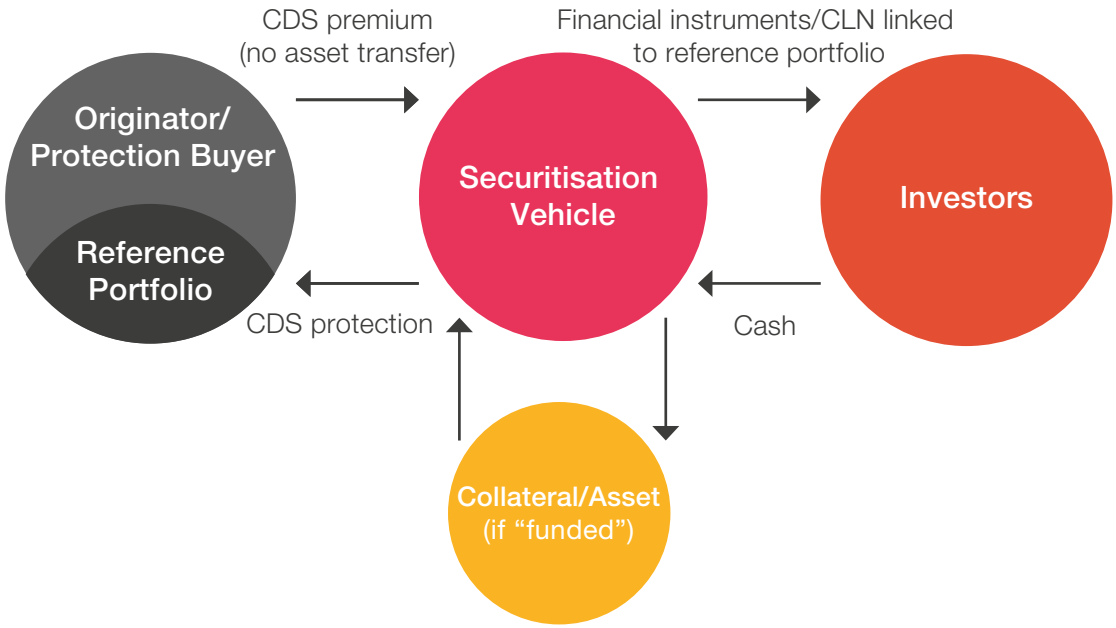
Credit risk may be transferred in a number of ways:

- The Protection Buyer might issue Credit-Linked Notes ("CLN") to the Protection Seller. The terms of the notes would provide for a reduction in the Protection Buyer's repayment obligation on the notes upon defaults or other credit events arising with respect to the Reference Portfolio.
- Alternatively, the Protection Buyer may enter into a Credit Default Swap ("CDS"), a Total Return Swap ("TRS") or other credit derivative transaction with the Protection Seller. In return for certain payments, the Protection Seller agrees – in the event of default or another credit event in respect of a Reference Portfolio – to pay an amount to the Protection Buyer. This is calculated based on the amount of defaulted payments or the reduction in market value of the defaulted Reference Portfolio.

The transaction may be funded or unfunded. In a funded transaction, the investors make an initial payment (e.g. to the counterparty or to a cash deposit or to purchase a risk-free investment) that serves as collateral to cover the counterparty risk. In an unfunded transaction, no such initial cash flow is required.

Figure 9 illustrates a typical synthetic securitisation structure.

Figure 9: Typical synthetic securitisation structure



2.3 Benefits of securitisation

Even if setting up a SV – a separate legal entity requiring several service providers – incurs a certain amount of costs, for the involved parties the benefits outweigh these costs. Below we present a non-exhaustive list of the usual benefits of a securitisation transaction, which may be favourable to one or more of the various parties. However, securitisation transactions are complex structured financing methods and it is crucial that potential issuers understand the range of options and related implications in order to make an informed decision. While these benefits have varying degrees of importance for different originators, the common characteristic of securitisation is the demand for lower funding cost.

Benefits for originators

Securitisation improves return on capital by converting an on balance-sheet lending business into an off-balance-sheet fee income stream that is less capital-intensive.
Depending on the type of structure used, securitisation may have the following benefits:

- **Providing efficient access to capital markets:** Structuring with high ratings is possible on most tranches of financial instruments issued. The non-existing link between the originator's credit rating and the rating of the securitised assets reduces the funding costs; for instance, a company rated BBB but having an AAA worthy cash flow from some of its assets, would be able to borrow at AAA rates. This is the main reason for the securitisation of cash flow, to achieve a significant impact on borrowing costs.

- **Minimising issuer-specific limitations on ability to raise capital:** Funding depends on the terms, credit quality, prepayment assumptions, servicing of the assets, and prevailing market conditions. Entities that are unable to fund themselves easily due to their individual credit quality, or that do so only at a significant cost, may be able to conduct securitisation transactions. This also applies to entities that are unable to raise equity.

- **Creating liquidity:** Assets that are not readily saleable may be combined to create a diversified collateral pool funded by financial instruments issued by a securitisation vehicle

- **Diversifying and targeting funding sources, investor base, and transaction structures:** Businesses can expand beyond existing bank lending and corporate debt markets by tapping into new markets and investor groups. The new funding sources may also reduce the costs of other types of debt by reducing the volume issued and allowing placements with marginal purchasers willing to pay a higher price. Especially for complex organisations, segmenting revenue streams or assets that back particular debt offerings, enables issuers to market debt to investors based on their appetite for particular types of credit risk. At the same time, it allows these investors to minimise their exposure to unrelated issuer risks. Similarly, complex principal and interest payments structural features targeting the investment objectives of particular buyers can be incorporated into the debt. This segmentation of credit risk and structural features should minimise the overall cost of capital of the seller.

- **Raising capital to generate additional assets or apply to other more valuable uses:** For example, this allows credit lines to be recycled quickly to generate additional assets, as well as frees long-term capital for related or broader uses. The capital raised can be used for any allowable purpose, such as reducing existing debt, repurchasing stock, purchasing additional assets or completing capital projects.

- **Raising capital without prospectus-type disclosure:** Allows sensitive information about business operations to be kept more confidential, especially by issuing through a "conduit" or as a private placement.

- **Generating earnings:** When a true-sale securitisation transaction takes place between the originator and the SV, it must take place at the market value of the

underlying assets. The transaction is reflected in the originator's balance sheet, which will eventually boost earnings or lock the level of profit resulting from the sale of assets for the particular quarter or financial year by the amount of the sale while passing the risks on.

- **Completing mergers and acquisitions, as well as divestitures more efficiently:** It may assist in creating the most efficient combined structure and may serve as a source of capital for transactions. By segmenting and selling assets against debt issued, it may be possible to optimise the closure of business lines that no longer meet corporate objectives. It may assist in creating the most efficient combined structure and may serve as a source of capital for transactions. By segmenting and selling assets against debt issued, it may be possible to optimise the closure of business lines that no longer meet corporate objectives.

- **Transferring risk to third parties:** Assets in the case of true-sale transactions or risks in the case of synthetic transactions can be partially or fully transferred to investors and credit enhancers.

- **Lowering capital requirements for banks and insurance companies:** The supervisory authorities set out minimum capital requirements for banks and insurance companies, in accordance with the size and nature of the risks borne by the company.

  By removing assets from the company's balance sheet, related capital requirements are released, which can then be used for other purposes. These capital requirements are described in more detail in Section 6.

Benefits for investors

- **Broad possible combinations of yield, risk, and maturity:** Securitised assets are usually structured to meet investors' requirements, investment strategies and appetite for risk. With this flexibility, securitised assets offer a range of attractive yields, payment streams, and risk profiles.

- **Tailored investment sources:** Investors who would normally not invest directly in the originator's securities would tend to have a different perspective and be attracted by the characteristics of securitised assets.

- **Portfolio diversification:** Some investors, like hedge funds or banks, tend to invest in bonds issued by securitisation vehicles, which are uncorrelated to their other investments.

- **Higher returns:** Because of securitised assets and underlying risk-return-maturity profiles, investors may potentially earn a higher rate of return on investments in a specific pool of high-quality credit-enhanced assets.

Benefits for borrowers

- **Better credit terms:** Borrowers benefit from the increasing availability of credit terms, which lenders may not have provided if they had kept the loans on their balance sheets. For example, lenders can extend fixed-rate debt, which many consumers prefer to variable-rate debt, without overexposing themselves to interest-rate risk. Credit card lenders can originate very large loan pools for a diverse customer base at lower rates.

2.4 Types of credit enhancements

Credit enhancements are initiatives taken by the originator to enhance the creditworthiness of the financial instruments issued to investors, so that the pool of underlying assets is able to withstand fluctuations in the economy and to protect investors from bearing all credit risks in the pool of assets. In addition, for the investors, this increases the probability of receiving the cash flow to which they are entitled and gives the securities a higher credit rating. Accordingly, both internal (techniques structured within the transaction) and external (insurance-type policies purchased to protect investors in the event of default) credit enhancements are typically built into the structure.

Setting up credit enhancements is an essential step of the structuring process that drives the ultimate rating of the financial instruments issued. Most structures contain a combination of one or more of the enhancement techniques described below.

From an issuer's point of view the objective is to find the most practical and cost-effective credit-protection method for the desired credit rating and pricing. Most financial instruments also contain performance-related features designed to protect investors (and credit enhancers) from portfolio deterioration. The originator will often negotiate the type and size of the internal and external credit enhancements with the rating agencies in order to accommodate the needs of the different investors. Some investors may request a AAA rating, which implies that such investment has a very low expected default risk. It is rather rare that a pool of, for example, residential mortgage loans, will have such a AAA rating. However, the default risk of this loan pool can be distributed differently to the different investors in a way that losses in the portfolio are first allocated to the lowest ranking position and only the additional losses to the most senior position. As such, this senior position (or tranche) would only suffer losses after a certain threshold of accumulated losses in the portfolio has been reached, while the junior tranche takes the hit immediately. With this "subordination" of the junior tranche compared to the senior tranche (see below), one could structure a pool of medium quality loans into a low risk and a high risk piece and cater different types of investors.

Common types of credit enhancements can be summarised as follows:

Internal credit enhancements

Over-collateralisation

Over-collateralisation is a commonly used form of credit enhancement. With this support structure, the notional value of the underlying asset portfolio is higher than the notional value of the financial instruments it backs. In other words, the financial instruments issued are over-collateralised. So even if some of the payments from the underlying assets are late or defaulted, principal and interest payments on the financial instruments issued can still be arranged.

Subordination

Subordination means that classes of financial instruments with different rights are issued within the same transaction and that some are subordinated to the rights of other classes of financial instruments.

Subordination usually relates to the rights of investors to receive expected payments, particularly in situations where there is not sufficient cash flow to pay the expected amounts to all investors. However, it may also relate to the investor's right to vote on issues concerning the operation of the transaction. Subordinated financial instruments are repayable only after other classes of financial instruments with a higher ranking have been satisfied ("waterfall payment"). The payments of senior tranches are protected by subordinated tranches in an event of losses.

Excess spread

The excess spread is the net amount of interest payments received from underlying assets after transaction administration expenses and investors' interest payments have been executed. The excess can be used to cover losses and to top up reserve funds.

Reserve fund

A reserve fund is an account available for use by the SV, for one or more specified dedicated purposes. Some reserve accounts are also known as "spread accounts". Virtually, all reserve accounts are at least partially funded at the start of the related transaction, but many are designed to be built up over time using the excess cash flow that is available after making payments to investors.

External credit enhancements

Third-party/Parental guarantees

In this case, a promise is provided by a third party or, in some cases, by the promoter of the securitisation transaction, to reimburse the SV for losses up to a specified amount. Transactions can also include agreements to advance principal and interest or to buy back any defaulted loans. AAA rated financial guarantors or insurance companies typically provide third-party guarantees.

Letters of credit

With a letter of credit ("L/C"), a financial institution – usually a bank – is receiving a fee for providing a specified amount of cash, to reimburse the SV for any cash shortfalls from the collateral – up to the required credit support amount. L/Cs are becoming less common forms of credit enhancement, as much of their appeal was lost, when the rating agencies downgraded the long-term debt of several L/C-provider banks in the fixed income sectors. Because notes enhanced with L/Cs from these lenders faced possible downgrades as well, issuers began to use cash collateral accounts instead of L/Cs in cases where external credit support was needed.

2.5 Parties involved in securitisation transactions

In addition to the parties directly involved, there are many others, generally defined as service providers, that are usually involved in the securitisation process. Figure 10 and the following paragraphs give an overview of the most relevant parties:

Arranger/Sponsor

The party (often a bank or an asset manager) that establishes the securitisation transaction and brings together the investors and the pool of assets. The arranger evaluates the assets, determines the characteristics of the financial instruments to be issued, assesses the need for specific structuring and arranges for distribution of the financial instruments to the investors.

Obligor/Borrower

Obligors owe the originator payments on the underlying loans/assets and are, therefore, the ultimate cause of the performance of the issued financial instruments. As obligors are often not informed about the sale of their payment obligation, the originator often maintains the customer relationship as servicer.

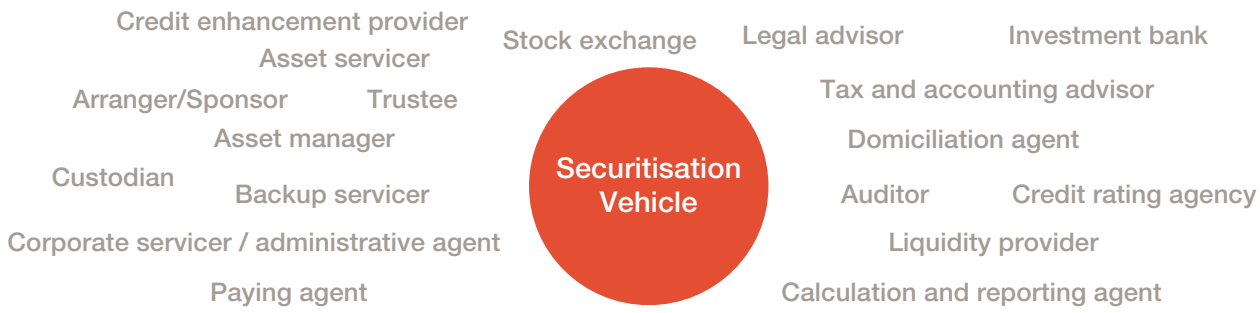
Originator

The originator is the entity to assign assets or risks in a securitisation transaction. It is usually the party (lender) who originally underwrites and securitises the claims (loans).

The obligations arising from such loans are originally owed to this entity before the transfer to the SV takes place.

Occasionally, the originator may be a third party who buys the pool of assets with the intention to securitise it later. In this case, the originator may also be named as “sponsor”. Originators include captive financial companies of the major car manufacturers, other financial companies, commercial banks, building societies, manufacturers, insurance companies, and securities firms.

Figure 10: The securitisation service providers



Investor

Investors buy the financial instruments issued by the SV and are thus entitled to receive the repayments and interest based on the cash flow generated by the underlying assets. Collaterals ensure the monetary claims from these assets. The largest investors are typically pension funds, insurance companies, investment funds, family offices, and – to a lesser extent – commercial banks. The most compelling reason for investing in Asset-Backed Securities is their higher rate of return compared to other assets with a comparable credit risk.

Asset servicer

The asset servicer is the entity that collects principal and interest payments from obligors and administers the portfolio after the transaction has closed. Regularly, the originator acts as asset servicer, but not always. For example, in most Non-Performing Loans ("NPL") transactions, specialised servicers tend to carry out this role. Servicing includes customer service and payment processing for the obligors in the securitised pool and collection actions in accordance with the pooling and servicing agreement. Servicing can further include default management, realisation of collaterals, and preparation of monthly reports. The asset servicer is typically compensated with a fixed or variable servicing fee.

Backup servicer

If the original servicer defaults, the backup servicer replaces him. The backup servicer takes over all the responsibilities allocated to the servicer.

Corporate servicer/administrative agent

The corporate servicer is the entity in charge of the administration, accounting, investor reporting, and preparation of the annual accounts of the SV. Furthermore, the corporate servicer files the annual accounts and the tax returns and may provide local directors.

Domiciliation agent

The domiciliation agent provides the legal registered office for the SV. The domiciliary agent is responsible for the performance of functions and duties associated with the physical domicile, such as the provision of office space, handling all correspondence addressed to the SV and arranging the settlement of bills on its behalf.

Trustee

Acting in a fiduciary capacity, the trustee is primarily concerned with preserving investors' rights. The trustee's responsibilities will vary from one case to another and are described in a separate trust agreement. Generally, the trustee oversees the receipt and disbursement of cash flow as prescribed by the indenture or pooling and servicing agreement and monitors other parties of the agreement to ensure that they comply with the appropriate covenants. If problems occur in the transaction (e.g. defaults), the trustee pays particular attention to the obligations and performance of all parties associated with the securities issued, notably the servicer and the credit enhancer. Throughout the lifetime of the transaction, the trustee receives periodic financial information from the originator/servicer detailing amounts collected, amounts charged off, collateral values, etc. The trustee is responsible for reviewing this information and ensuring that the underlying assets produce adequate cash flow to serve the financial instruments issued. The trustee is also responsible for declaring default or amortisation events.

Investment bank

Investment banks mainly structure, underwrite and market the securitisation transaction.

Tax and accounting advisor

These advisors provide assistance on the accounting and tax implications respectively of the proposed structure of the transaction. Issuers usually aim to choose structures that will allow the tax impact on the financial instruments issued to be minimised.

Credit rating agency

The financial instruments issued may be assessed by a credit rating agency to allocate a rating to them. A wide range of investors requires a minimum rating of investment grade or higher. The rating process is dominated by Big Three credit rating agencies Standard & Poor's, Moody's, and Fitch. They use their accumulated expertise, data and modelling skills to assess the expected loss of debt securities issued by the securitisation vehicle. But there is also a high number of other credit rating agencies that have been registered or certified in accordance with the EU Credit Rating Agencies Regulation (see **https://www.esma.europa.eu/regulation/credit-rating-agencies**).

In general, credit rating agencies review the following factors:

- Quality of the pool of underlying assets in terms of repayment ability, maturity diversification, expected defaults, and recovery rates;
- Abilities and strengths of the originator/servicer of the assets;
- Soundness of the transaction's overall structure, e.g. timing of cash flow (or mismatch) and impact of defaults;
- Analysis of legal risks in the structure, e.g. effectiveness of transfer of title to the assets;
- Ability of the asset manager to manage the portfolio; and
- Quality of credit support, e.g. nature and levels of credit enhancements

Paying agent

Paying agents are usually banks that have agreed to settle the payments on the financial instruments issued to investors. Payments are usually made via a clearing system.

Legal advisor

As the legal structure and legal opinions are crucial to securitisation, considerable legal work goes into documentation. A typical transaction involves numerous documents: articles of incorporation, sale and purchase agreements, offering documents, etc.

Credit enhancement provider

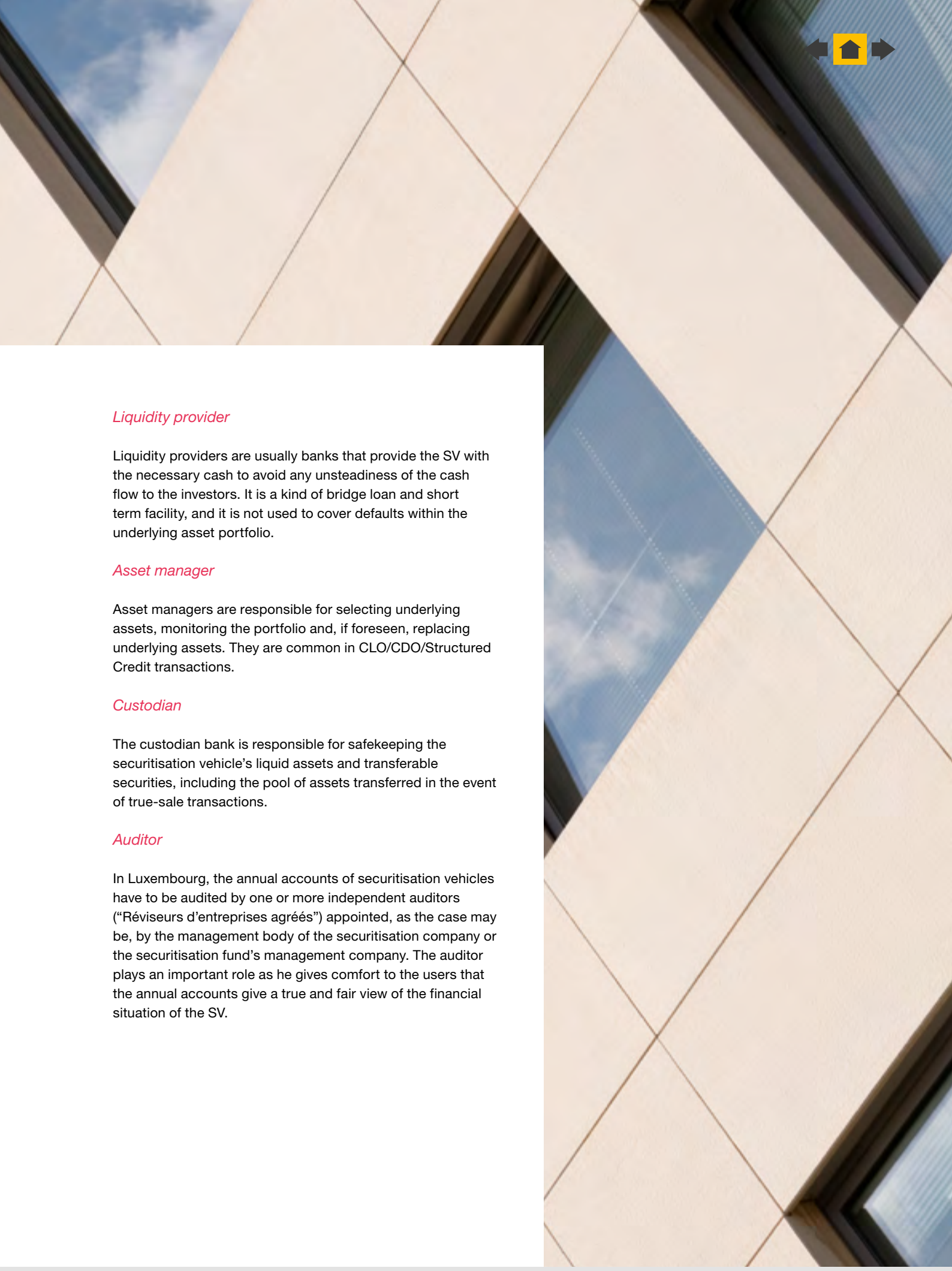
Credit enhancement is used to improve the credit rating of the issued financial instruments. Therefore, credit enhancement providers are third parties agreeing to elevate the credit quality of another party or a pool of assets by making payments, usually up to a specified amount. This provision is made in case the other party defaults on their payment obligations, or the cash flow generated by the pool of assets is less than the amounts contractually required, due to defaults of the underlying obligors.

Calculation and reporting agents

This entity calculates the waterfall principal and interest payments due to creditors and investors.

Stock exchange

A stock exchange facilitates the access of investors to the financial instruments issued and vice versa. It provides a marketplace with information, listing and trading facilities. A stock exchange may have several market segments with a different level of regulation and characteristics.



Liquidity provider

Liquidity providers are usually banks that provide the SV with the necessary cash to avoid any unsteadiness of the cash flow to the investors. It is a kind of bridge loan and short term facility, and it is not used to cover defaults within the underlying asset portfolio.

Asset manager

Asset managers are responsible for selecting underlying assets, monitoring the portfolio and, if foreseen, replacing underlying assets. They are common in CLO/CDO/Structured Credit transactions.

Custodian

The custodian bank is responsible for safekeeping the securitisation vehicle's liquid assets and transferable securities, including the pool of assets transferred in the event of true-sale transactions.

Auditor

In Luxembourg, the annual accounts of securitisation vehicles have to be audited by one or more independent auditors ("Réviseurs d'entreprises agréés") appointed, as the case may be, by the management body of the securitisation company or the securitisation fund's management company. The auditor plays an important role as he gives comfort to the users that the annual accounts give a true and fair view of the financial situation of the SV.

3

The Luxembourg Securitisation Law

3.1 Scope of Luxembourg securitisation vehicles

3.1.1 Broad definition of securitisation

Compared to the definition of securitisation in the European legislation, the Luxembourg Securitisation Law provides a rather broad and flexible approach. While the EU Securitisation Regulation, Capital Requirements Regulation (CRR) and Solvency II Directive require that the securities issued by a securitisation vehicle transfer credit risk and are split into multiple tranches, the Luxembourg Securitisation Law does not contain such restrictions. It encompasses all transactions wherein a securitisation vehicle:

- acquires or assumes (directly or indirectly);
- any risk relating to claims, other assets or obligations assumed by third parties or inherent in all or part of the activities of third parties; and
- issues financial instruments (e.g. debt or equity securities, loans) whose value or yield depends on such risks.

The fact that the securitisation vehicle is no longer required to issue highly formalised "securities" but more flexible "financial instruments" allows to further adapt a securitisation structure to specific needs and reduce cost.

Transactions securitising other than credit risk, such as market risks or commodity risks, can also use a Luxembourg securitisation vehicle while not being subject to the EU Securitisation Regulation. In addition, non-tranched securities for which all investors have the same risks and rewards, can also be issued, again, without being subject to the EU Securitisation Regulation.

To qualify as a Luxembourg securitisation vehicle governed by the Luxembourg Securitisation Law, entities must only state in their articles of incorporation or management regulations (for securitisation funds) that they are subject to the provisions of the Luxembourg Securitisation Law ("opt-in").

3.1.2 Few limits for securitisation activities

The Luxembourg Securitisation Law allows for a wide range of assets to be securitised, such as trade receivables, mortgage loans (commercial or residential), shares, bonds, commodities, and essentially, any tangible or intangible asset or activity with a reasonably ascertainable value or predictable future stream of revenues. Furthermore, the Luxembourg Securitisation Law does not prescribe any specific diversification requirements. A securitisation vehicle transforms these assets or risks into financial instruments whose repayable amount is linked to the risks or assets that are being securitised.

Luxembourg securitisation transactions may be achieved by transferring the legal ownership of the assets ("true-sale") or by only transferring the risks linked to these assets, e.g. via derivatives or guarantees ("synthetic"). They can be set up either as a long-term securitisation or as a short-term Commercial Paper Programme ("Asset-Backed Commercial Paper" or "ABCP").

The specific nature of the securitisation undertaking's activity requires that the risks it securitises result exclusively from assets, claims, or obligations assumed by third parties or are inherent in all or part of the third parties' activities.

In principle, they cannot be generated by the securitisation undertaking itself or result as a whole or in part from the securitisation undertaking acting as entrepreneur.

The role of the securitisation undertaking is normally limited to administering financial flows linked to the securitisation transaction itself and to the "prudent-man" management (in contrast to "active management") of the securitised risks, while any activity likely to qualify the securitisation undertaking as an entrepreneur is prohibited.

The Luxembourg Securitisation Law itself gives only limited guidance to what exactly has to be understood by those terms. Therefore, the CSSF has interpreted them in a "Frequently Asked Questions" section published on its website[1].

[1] This interpretation is primarily addressed to securitisation vehicles supervised by the CSSF. Nevertheless, in practice, it serves as a reference interpretation of the Luxembourg Securitisation Law. *https://www.cssf.lu/en/supervision/ivm/securitisation/faq/*

However, with the modernisation of the Luxembourg Securitisation Law in 2022, active management (performed by the vehicle or a third party) is now permitted for Luxembourg securitisation vehicles with investments linked to bonds, loans or other debt instruments, except if the financing instruments are issued to the public. Any activity which aims to promote the commercial development of the securitisation undertaking's activities remains prohibited.

In this context, the following types of transactions would still qualify as securitisation structures under the Luxembourg Securitisation Law:

- Granting loans instead of acquiring them on the secondary market, provided that the investor is sufficiently informed and that the securitisation vehicle is not acting on its own account, i.e. that those loans are set up upstream by or through a third party;
- Securitising existing portfolios of partially drawn credits and of automatically revolving credits under predefined conditions which does not lead by any means to the securitisation vehicle performing a professional credit activity in its own name;
- Acquiring goods and equipment and structuring the transaction in a way similar to a leasing transaction;
- Repackaging structures consisting in setting up platforms for structured products; and
- Holding shares and fund units, provided that the securitisation vehicle does not actively intervene in the management of such entities, acts solely as a financial investor interested in receiving cash flow (e.g. dividends) and is not misused as a group holding company.

3.2 Flexible and robust legal environment

The legal aspects described in this section illustrate some of the main characteristics of the Luxembourg Securitisation Law, including high flexibility, investor protection and efficiency for the originator.

3.2.1 Possible legal forms

Modelled on the well-known investment fund regime in Luxembourg, the Luxembourg Securitisation Law introduced securitisation vehicles in the form of both corporate entities and securitisation funds, managed by a management company and governed by management regulations. The Figure 11 (see next page) provides an overview of the legal types of Luxembourg securitisation vehicles.

Securitisation companies can take one of many legal forms, with the last four added by the modernisation of the law in 2022:

- "*Société anonyme*" ("SA", equivalent to a public limited company); or
- "*Société à responsabilité limitée*" ("SARL", equivalent to a private limited liability company); or
- "*Société en commandite par actions*" ("SCA", partnership limited by shares); or
- "*Société coopérative organisée comme une SA*" ("Scoop SA", a cooperative company organised as a public limited company); or
- "*Société en nom collectif*" ("SNC", equivalent to a general partnership); or
- "*Société en commandite simple*" ("SCS", common limited partnership); or
- "*Société en commandite spéciale*" ("SCSp", special limited partnership); or
- "*Société par actions simplifiée*" ("SAS", public simplified company).

Securitisation companies are not subject to a specific regulatory minimum capital requirement, but only to the minimum capital prescribed for the respective legal form (e.g. EUR 30,000 for an SA and EUR 12,000 for an SARL). This minimum share capital refers to the whole legal entity and not to each single compartment.

Besides setting up a company, a securitisation vehicle can also be organised in a purely contractual form as a securitisation fund. The securitisation fund does not have a legal personality. It will, however, be entitled to issue units representing the rights of investors, in accordance with the management regulations. A securitisation fund may also issue debt instruments. Similar to a securitisation company, a securitisation fund can be created with a small number of fund units and financed almost entirely by the issue of debt instruments.

In the absence of legal personality, the securitisation fund may be organised as one or several co-ownership(s) or one or several fiduciary estate(s). In both cases, the securitisation fund will be managed by a management company, which is a commercial company with a legal personality in Luxembourg.

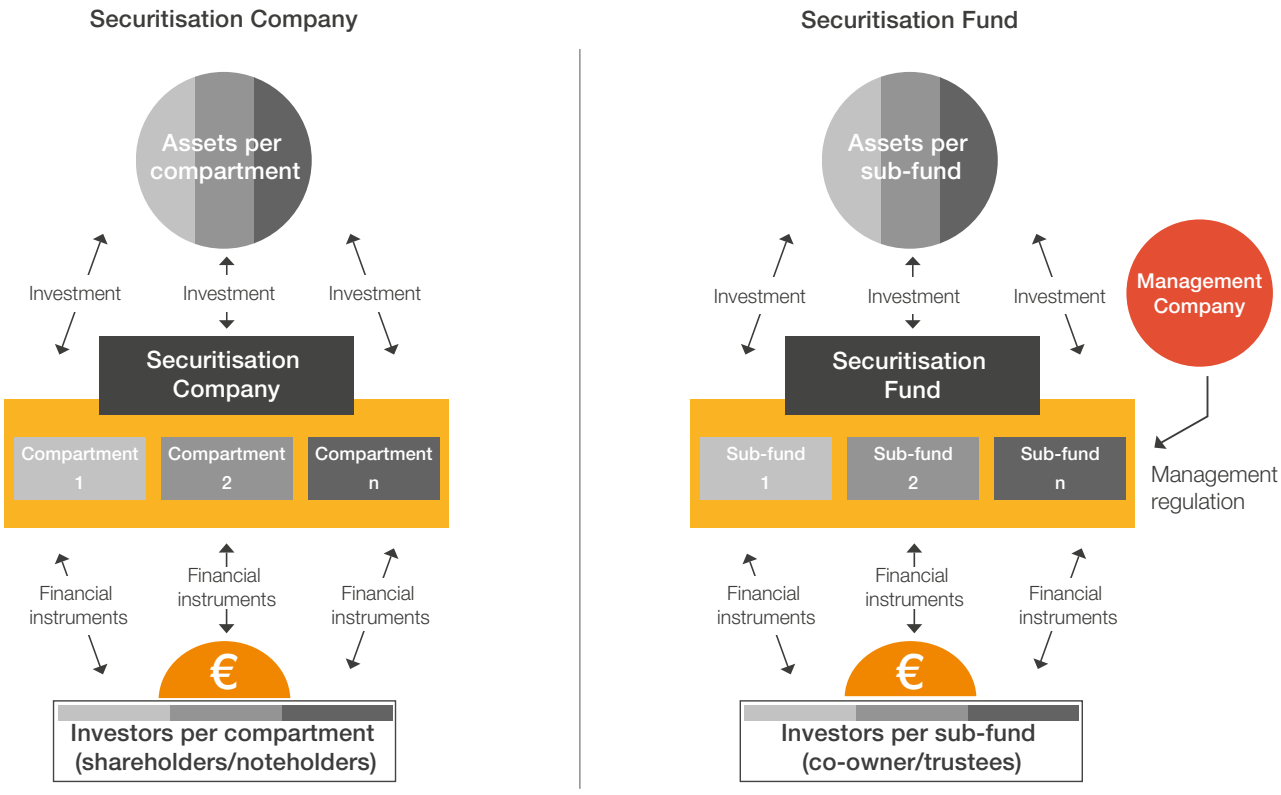
With the modernisation of the Luxembourg Securitisation Law, a securitisation fund now also has to be registered directly with the Luxembourg trade and companies register.

3.2.2 Ability to create compartments

One of the main advantages cited by many market participants, is the possibility to create several compartments within one legal entity or fund. This concept is adapted from the popular umbrella-fund structure and permits a time and cost efficient solution for frequent issuer vehicles. Precondition for the creation of multiple compartments is simply that the securitisation company's articles of incorporation or the management regulations of a securitisation fund authorise the Board to create separate compartments or sub-funds, respectively. This allows each compartment to correspond to a distinct portion of assets financed by distinct securities. The compartments allow a pool of assets and corresponding liabilities to be managed separately, so that the result of each pool is not influenced by the risks and liabilities of other compartments. Each compartment can be liquidated separately.

The compartment segregation of the securitisation vehicle – a technique initially applied to investment funds in Luxembourg – also characteristically illustrates the combination of great flexibility and legal certainty that securitisation transactions in Luxembourg provide. Notably, this compartment segregation technique is either not applied or is not regulated by law in many other jurisdictions.

Figure 11: Legal form of securitisation vehicles and creation of compartments



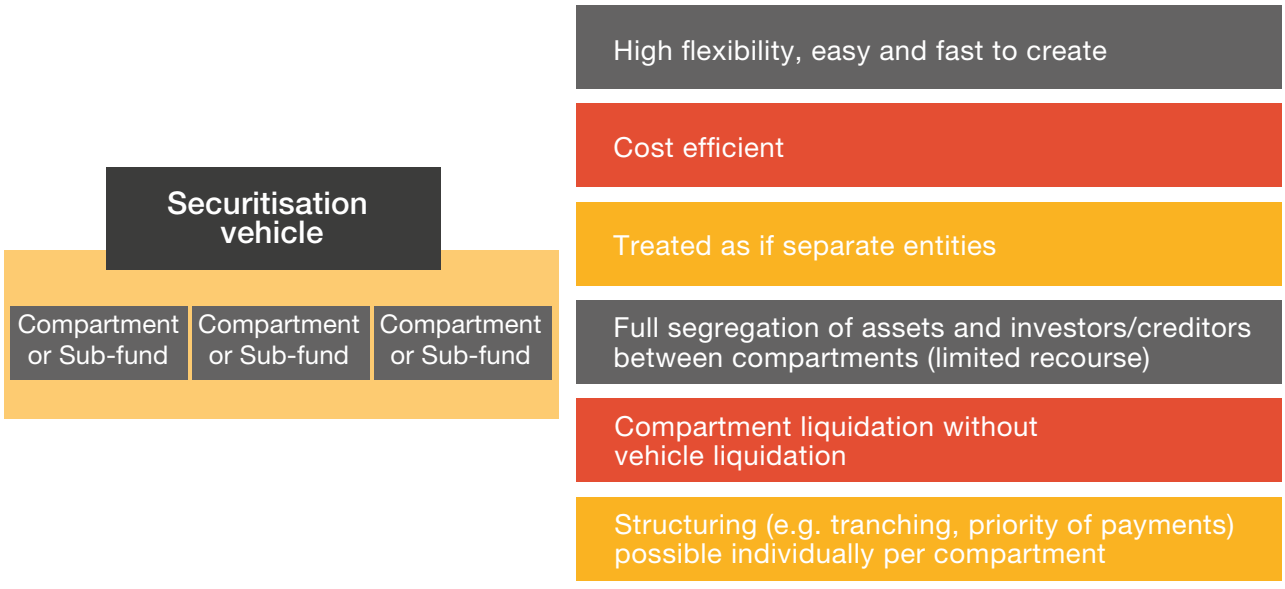
Compartment segregation means that the assets and liabilities of the vehicle can be split into different compartments, each of which is treated as if it were a separate entity executing distinct transactions. The rights of investors and creditors are limited to the risks of a given compartment's assets. The characteristics and rules applicable to each compartment or sub-fund may be governed by separate terms and conditions respectively management regulations. There is no recourse against the assets allocated to other compartments in the event that the claims under the securities held by the investors are not fully satisfied with the assets of the compartment in which they have invested. Each of the compartments can be liquidated separately without any negative impact on the vehicle's remaining compartments, i.e. without triggering the liquidation of other compartments. If the securitisation vehicle is a corporate entity, all compartments can be liquidated without necessarily liquidating the whole vehicle (while the liquidation of the last sub-fund of a securitisation fund would entail the securitisation fund's liquidation).

In addition, the securitisation vehicle or one of its compartments may issue several tranches of securities corresponding to different collaterals/risks and providing different values, yields and redemption terms. Limited recourse, subordination and priority of payment provisions, contractually agreed upon between the investors of tranches, may freely organise the rights and the rank between the investors and the creditors of a same compartment. However, this is only possible if provided for in the articles of incorporation, management regulations or issuance agreement. In the case of a two-tier structure, where the acquisition vehicles are separated from the issuing vehicle, the value, yield and repayment terms of the transferable securities issued by the issuing vehicle may also be linked to the assets and liabilities of the acquisition vehicles.

With the modernisation of the Luxembourg Securitisation Law it has now also been clarified that the compartment segregation remains when several compartments are equity financed, i.e. decisions like profit distribution are to be made on compartment level.

The main characteristics of compartment segregation are summarised in Figure 12.

Figure 12: Compartment segregation



3.2.3 Ability to issue fiduciary notes

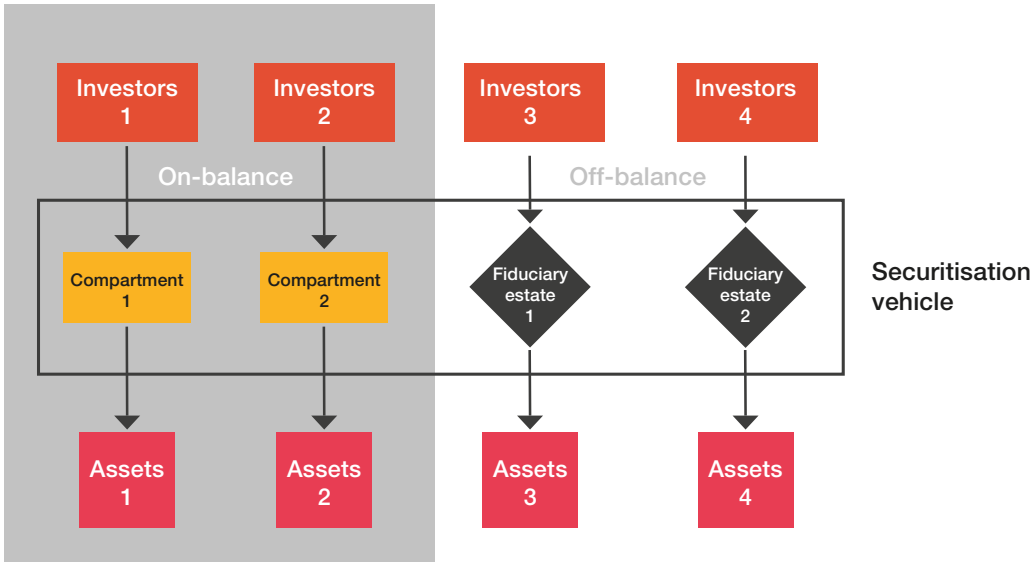
The Law of 27 July 2003 related to trust and fiduciary contracts ("Fiduciary Law") allows securitisation vehicles to act as a fiduciary and to issue notes on a fiduciary basis in their own name, but at the sole risk and for the exclusive benefit of the noteholder. In this case, the securitisation vehicle issues fiduciary notes that incorporate a fiduciary contract between the securitisation vehicle ("fiduciary") and the noteholder ("fiduciant"). Under the fiduciary contract, the noteholder transfers the ownership of certain assets ("fiduciary estate") to the fiduciary and instructs the fiduciary how to invest the issuance proceeds. The assets purchased by the securitisation vehicle in a fiduciary capacity and the returns generated by the assets are transferred to the noteholder. The notes issued by a securitisation vehicle on a fiduciary basis do not constitute debt obligations by the securitisation vehicle but are solely fiduciary obligations of the fiduciary and may be satisfied only out of the fiduciary assets.

Pursuant to the Fiduciary Law, the fiduciary assets (initial issuance proceeds and assets acquired) are segregated from all other assets of the fiduciary as well as from other fiduciary estates and noteholders recourse against the fiduciary is limited to the fiduciary assets (illustrated in Figure 13)

Similar to the creation of compartments, a securitisation vehicle may create several fiduciary estates in connection with the issue of series of notes issued by it. There is no recourse of investors and creditors against the assets allocated to other fiduciary estates.

The fiduciary transactions are recorded off-balance sheet by the securitisation vehicle, while still requiring sufficient disclosure in the financial statements.

Figure 13: Fiduciary structure



3.2.4 Numerous asset classes allowed

Another aspect of the Luxembourg Securitisation Law's great flexibility, is the wide range of asset classes that qualify for securitisation. The Luxembourg Securitisation Law does not limit securitised assets. In its early phases and in other jurisdictions, the securitisation market essentially covered assets like loans and receivables acquired from financial institutions, such as mortgage-backed loans, credit card receivables, and student loans.

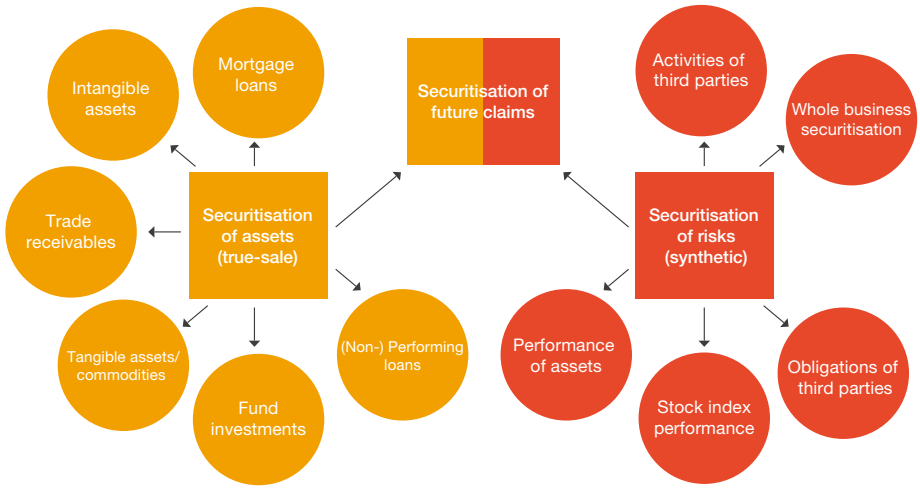
Today, however, and especially in Luxembourg thanks to the flexibility of the dedicated Luxembourg Securitisation Law, securitisation transactions also include tangible asset classes, such as aircrafts, railcars, and commodities, as well as intangible assets, such as intellectual property or any type of rights.

Under the Luxembourg Securitisation Law, it is also possible to securitise risks only, without acquiring the referring asset (so-called "synthetic" transactions). The securitised risks may relate to assets (whether movable or immovable, tangible or intangible) or result from obligations assumed by third parties. They may also be related to all or part of the activities of third parties. Thus, a securitisation vehicle can assume risks by acquiring the underlying assets themselves ("true-sale"), or by guaranteeing the third party's obligations or committing itself in any other way, e.g. via derivatives ("synthetic") (see Figure 14).

A securitisation vehicle may not only securitise existing claims, but also future claims. The latter may arise (i) from an existing or future agreement, provided that such claims can be identified as being part of the assignment at the time they come into existence; or (ii) from future claims originating from future contracts, provided that such claims are sufficiently identified at the time of the sale or any other agreed time.

As outlined in Section 1, the main asset classes securitised through Luxembourg securitisation vehicles are securities, loans, mortgages, non-performing loans, auto loans, lease receivables, trade receivables, receivables in connection with real estate or loans in relation with SME financing. For many years, "trackers", certificates, directly or indirectly linked to the value of an index or another underlying asset and structured for retail investors, have afforded great success in Luxembourg.

Figure 14: No restrictions for asset classes and risk transfer



3.2.5 Different forms of risk transfer and transaction types possible

True-sale vs. synthetic

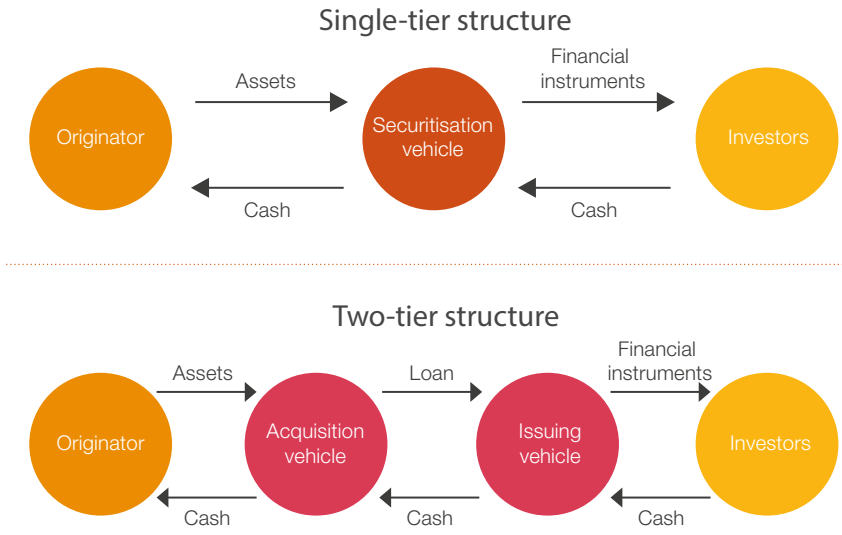
Securitisation transactions can be executed in the two forms true-sale or synthetic. Within the scope of a "true-sale" transaction, the originator sells the ownership in a pool of assets to a securitisation vehicle. Within the scope of a "synthetic" transaction, however, the originator buys credit/market risk protection (through a series of credit derivatives or swaps, guarantees or similar), without transferring the ownership of the underlying assets.

Single vs. two-tier structure

As shown in Figure 15, it is possible to structure securitisation transactions as single or as two-tier structures. In a single tier structure, the purchase of the assets or risks, as well as the issuance of the financial instruments is made by one single securitisation vehicle. In contrast, in a two-tier structure, the functions of acquisition of assets/risks and issuing of financial instruments would be split amongst two or more vehicles. They would be referred to as "acquisition vehicle(s)" and "issuing vehicle", respectively, while the latter is back-to-back financing the former. The repayment of the securities issued by the issuing vehicle would be linked to the assets/risks and liabilities of the acquisition vehicle(s).

In a two-tier structure under the Luxembourg Securitisation Law, the acquisition vehicles can also be established in the countries of the originators or in the countries where the transferred assets are located, which may be advantageous for legal, tax or operational purposes. It might also be that the acquisition vehicle is set up in another legal form (e.g. an investment fund) not subject to the Luxembourg Securitisation Law.

Figure 15: Single vs. two-tier structure



3.3 Supervision of securitisation vehicles

3.3.1 Preconditions for authorisation requirement

The Luxembourg Securitisation Law differentiates between authorised and non-authorised entities. Authorised securitisation vehicles are authorised and supervised by the CSSF, which is responsible for ensuring that they comply with the Luxembourg Securitisation Law and fulfil their obligations.

A securitisation vehicle is subject to mandatory CSSF supervision if it issues financial instruments (i) to the public and (ii) on a continuous basis. In order to be subject to mandatory supervision, each of the two conditions must be met (see Figure 16).

Since its modernisation, the Luxembourg Securitisation Law defines the notion of "public", similar to former CSSF FAQ:

- Issues to professional clients within the meaning of Art. 1 (5) of the financial sector Law of 5 April 1993 are not issues to the public;
- Issues whose denominations equal or exceed EUR 100,000 are assumed not to be placed with the public;
- The listing of an issue on a regulated or alternative market does not necessarily imply that the issue is deemed to be placed with the public;
- Issues distributed as private placements, whatever their denomination, are not considered to be issues to the public. Based on the existing CSSF guidance, the CSSF assesses whether the issue is to be considered a private placement on a case-by-case basis according to the communication means and the technique used to distribute the securities. However, the subscription of financial instrumentsby an institutional investor or financial intermediary for a subsequent placement of such financial instruments with the public constitutes a placement with the public.

Therefore, issues to professional investors and private placements are not considered to be issues to the public[1].

The Luxembourg Securitisation Law now also defined the notion "on a continuous basis" as when the securitisation vehicle issues financial instruments more than three times per calendar year. In the case of a multi-compartment securitisation vehicle, the number of issues per year has to be determined on the level of the securitisation vehicle and not on the compartment level. Furthermore, following the existing CSSF guidance, when issuing financial instruments under an issuance programme, each series is assumed to be a distinct issue to be counted separately for this purpose (unless further analysis of programme and series leads to the conclusion that they rather demonstrate the characteristics of one single issue).

However, because of the cumulative nature of the two conditions, a one-off issue of securities to the public as well as the continuous issue of securities with a denomination above EUR 100,000 may be carried out without prior approval from the CSSF.

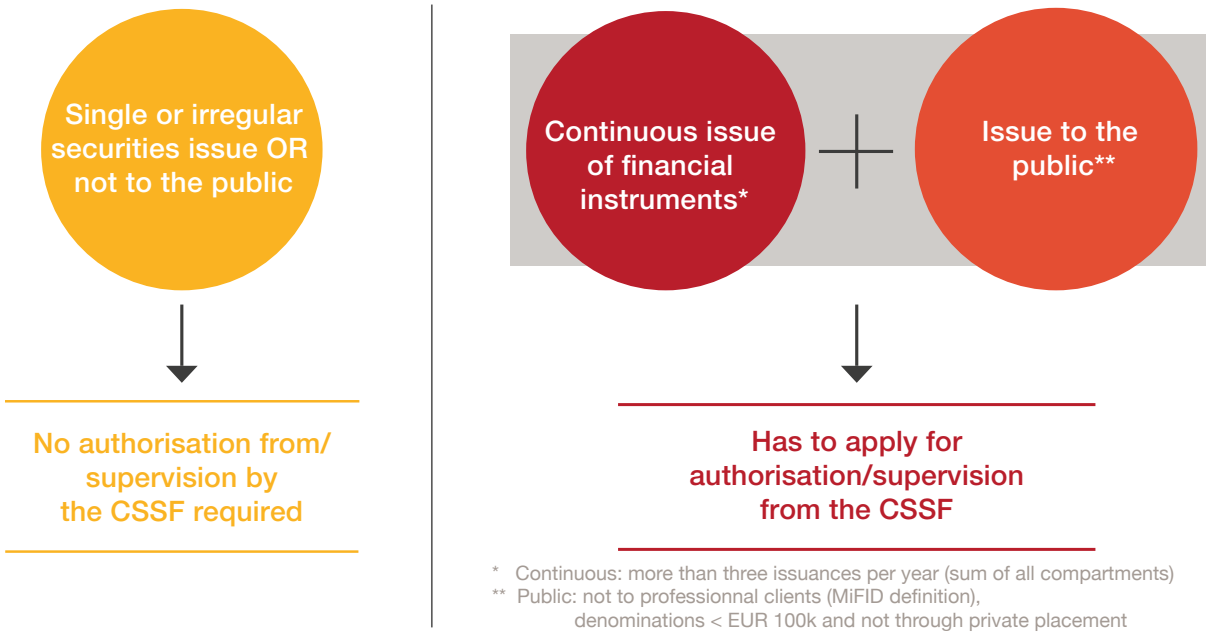
[1] Please note that the definition of the term "public" in the area of securitisation is not the same as the one of the Law of 10 July 2005 on prospectuses for securities, which defines the notion "offer to the public" and whose determining criterion is that of a proactive approach of solicitation and a specific offer adopted by the banker.

3.3.2 Initial authorisation by the CSSF

Authorisation by the CSSF means that the CSSF has to approve the articles of incorporation or management regulations of the securitisation vehicle and if necessary, authorise the management company. The same procedure applies for existing securitisation vehicles that have not been authorised before but now intend to issue securities to the public on a continuous basis.

To grant approval, the CSSF must be informed of the identity of the members of the securitisation vehicle's administrative, management and supervisory bodies. In the case of a regulated securitisation fund's management company, the shareholders in a position to exercise significant influence need to be named. The directors or managers of a securitisation company or a management company of a securitisation fund must be of good repute and have adequate experience and means required to perform their duties. The CSSF requires at least three board members for authorised securitisation vehicles, but allows legal persons to act as board members. In such cases, a natural person needs to be designated to represent this legal person and the CSSF will assess the criteria regarding the board members' competence and reputation at the level of the representatives of the legal persons acting as board member.

Figure 16: CSSF supervision



Securitisation companies and management companies of securitisation funds must have an adequate organisation and human and material resources to exercise their activities correctly and professionally. Structuring and management of the assets can be delegated to other professionals, including in foreign countries. Yet in such a case, an appropriate information exchange mechanism between the delegated functions and the Luxembourg-based administrative body must be established. The organisational structure must allow the external auditor and the CSSF to exercise their supervisory tasks.

The prudential supervision exercised by the CSSF aims to ascertain whether the authorised securitisation vehicle complies with the Luxembourg Securitisation Law and its contractual obligations. Any change to the securitisation vehicle's articles of incorporation, managing body, or external auditor must be reported to the CSSF immediately and is subject to the CSSF's prior approval. Any change in the control of the securitisation vehicle or management company is subject to the CSSF's prior approval.

A further requirement for authorised securitisation vehicles is that their liquid assets (e.g. cash) and securities must be held in custody by a Luxembourg credit institution.

For the authorisation process, at least the following elements must be included in the approval file to the CSSF:

- the securitisation vehicle's articles of incorporation or management regulations, or their drafts;
- the identity of the members of the Board of the securitisation vehicle or its management company, as well as the identity of the other managers of the securitisation vehicle or its management company, their CVs and extracts from their police records;
- the identity of the shareholders who are in a position to exercise a significant influence on the business conduct of the securitisation vehicle or its management company and their articles of incorporation;
- the identity of the initiator and, where applicable, its articles of incorporation;
- information concerning the credit institution responsible for the custody of assets;
- information concerning the administrative and accounting organisation of the securitisation vehicle;
- the agreements or draft agreements with service providers;
- the identity of the external auditor; and
- the draft documents relating to the first issue of securities, or, for active securitisation vehicles, the agreements relating to the issue of securities and other documents relating to securities already issued.

In addition to the approval file, the CSSF usually requires the initiator to personally present the intended securitisation transaction.

After authorisation, the CSSF enters the authorised securitisation vehicle on an official list. Being mentioned on that official list shall establish authorisation by the CSSF and the status as supervised securitisation vehicle; the securitisation vehicle is notified accordingly. This list and any amendments are published on the CSSF website.

3.3.3 Continuous supervision by the CSSF

The Luxembourg Securitisation Law has vested the CSSF with the authority to perform ongoing supervision of authorised securitisation vehicles. It has wide investigative powers regarding all elements likely to influence the security of investors. For this purpose, the CSSF has defined specific legal reporting requirements, which can be classified into three categories:

(i) The following documents need to be submitted to the CSSF ad-hoc as soon as they are finalised initially or updated thereafter:

- the final issue documents relating to each issue of securities;
- a copy of the financial reports drawn up by the securitisation vehicle for its investors and rating agencies, where applicable;
- a copy of the annual reports and documents issued by the external auditor resulting from its audit of the annual accounts (including the management letter or, where no such management letter has been issued, a written statement from the external auditor confirming that fact);
- information on any change of service provider and substantive provisions of a contract, including the conditions applicable to the issued securities; and
- information on any change relating to fees and commissions.

(ii) On a semi-annual basis, the CSSF requires the securitisation vehicles to provide, within 30 days, statements on new issues of financial instruments, outstanding issues and issues that have been redeemed during the period under review.

In connection with each issue the securitisation vehicle should report the nominal amount issued, the nature of the securitisation transaction, the investor profile and, where applicable, the compartment concerned. In addition, the semi-annual report should include a brief statement of the securitisation vehicle's financial position and notably a breakdown (by compartment, where applicable) of its assets and liabilities. There are no special requirements regarding the submission format or information medium used.

(iii) In addition, at the financial year-end, a draft balance sheet and a profit and loss account (by compartment, where applicable) must be added and provided within 30 days. The audited annual accounts and the management letter issued by the auditor must be provided to the CSSF within six months of the financial year-end.

The CSSF may also require any other information or perform on-site inspections and review any document of the securitisation company, the management company of a securitisation fund, the corporate servicer, or the credit institution in charge of safekeeping the assets of the securitisation undertaking. This allows the CSSF to verify compliance with the provisions of the Luxembourg Securitisation Law and the rules laid down in the articles of incorporation or management regulations and securities issue agreements, as well as the accuracy of the communicated information.

3.4 Luxembourg as an attractive marketplace

3.4.1 Enhanced investor protection

As there is no limitation on the investor basis, investments into a Luxembourg securitisation vehicle are open to all types of investors. Therefore, one of the most important aspects of the Luxembourg Securitisation Law is to ensure enhanced investor protection. The bankruptcy remoteness principle separates the securitised assets from any insolvency risks of the securitisation vehicle or of the originator, service provider and all other involved parties. In the event of bankruptcy of the originator or the servicer to whom the securitisation vehicle has delegated the collection of the cash flow from the assets, the Luxembourg Securitisation Law states that the securitisation vehicle is entitled to claim the transfer of ownership of the securitised assets and any cash collected on its behalf before liquidation proceedings are opened.

Moreover, the Luxembourg Securitisation Law allows for contractual provisions that are valid and enforceable and which aim to protect the securitisation vehicle from the individual interests of involved parties, consequently enhancing the securitisation vehicle's protection as follows:

- **Subordination provision:** Investors and creditors may subordinate their rights to payment to the prior payment of other creditors or other investors. This provision is crucial for tranching the securitisation transaction;
- **Non-recourse provision:** Investors and creditors may waive their rights to request enforcement. This means, for example, that if a payment of interest is in default, the investor may agree to wait for payment and not initiate legal action, as the situation is known or temporary; and
- **Non-petition provision:** Investors and creditors may waive their rights to initiate a bankruptcy proceeding against the securitisation vehicle. This clause protects the vehicle against the actions of individual investors who may have, for example, an interest in a bankruptcy proceeding against the vehicle.

In addition, the Luxembourg Securitisation Law provides that the assets are exclusively available to satisfy investors' claims in the securitisation vehicle or in a compartment in case of several compartments, and to satisfy creditors' claims in connection with such assets. Therefore, compartment segregation prevents insolvency contamination between different compartments.

3.4.2 Qualified service providers

The following parties provide high investor protection as well as business opportunities for Luxembourg market players.

3.4.2.1 The custodian

The custodian is an important player in the securitisation vehicle's business activities. The custodian is responsible for keeping the documentation proving the existence of securitised assets and guaranteeing that these assets, in the form of cash or transferable securities held by a securitisation vehicle, are kept under the best conditions for the investor.

To guarantee this, the Luxembourg Securitisation Law requires that authorised securitisation vehicles must entrust the custody of their liquid assets and securities in a credit institution established or having its registered office in Luxembourg. As there is no specific regime for the custody of the assets, the custodian of an authorised securitisation vehicle is not subject to any supervisory duty, but only to the duty of properly safekeeping the assets entrusted under custody. A different custodian may be designated for each compartment.

There are no such requirements for unauthorised vehicles.

3.4.2.2 The auditor

Irrespective of their legal form and the accounting framework adopted, securitisation vehicles must be audited by an approved independent auditor ("Réviseur d'entreprises agréé") appointed by the management body of the securitisation vehicle or by the management company of the securitisation fund. For an authorised securitisation vehicle supervised by the CSSF, the approved independent auditor must be authorised by the CSSF.

The EU audit legislation introduced more detailed requirements regarding the statutory audit of Public Interest Entities ("PIEs"). The requirements have been enacted in Luxembourg with the Law of 23 July 2016 concerning the audit profession and apply since the first financial year which started on or after 17 June 2016. The general rule under the EU Audit Legislation is that all PIEs, i.e. all securitisation vehicles having securities listed on an EU-regulated market, must rotate their auditor after a maximum period of ten years, with the possibility of a further ten year extension based on a tender (or 14 years in case of joint audit). Transition arrangements for the new rotation requirement are implemented by the legislator depending on the date that the auditor was appointed.

3.4.2.3 The fiduciary representative

Fiduciary representatives are professionals of the financial sector who can be entrusted with safeguarding the interests of investors and certain creditors.

In their capacity as fiduciary representatives and in accordance with the legislation on trust and fiduciary agreements, the fiduciary representatives can accept, take, hold and exercise all sureties and guarantees on behalf of their clients and ensure that the securitisation vehicle manages the securitisation transactions properly. The extent of such rights and powers is laid down in a contractual document to be concluded with the investors and creditors, whose interests the fiduciary representatives are to defend. If and for as long as one or more fiduciary representatives have been appointed, all individual rights of represented investors and creditors are suspended.

Fiduciary representatives also require authorisation by the Minister with responsibility for the CSSF. They must have their registered office in Luxembourg and they may not exercise any activity other than their principal activity, except on an accessory and ancillary basis. The authorisation for exercising the activity of a fiduciary representative can only be granted to stock companies with a share capital and own funds of at least EUR 400,000.

Even if the Luxembourg Securitisation Law has been in place for many years and although the Luxembourg Securitisation Law provides a special legal framework for such independent professionals, who are responsible for representing investors' interests, no fiduciary representative is registered in Luxembourg.

3.4.3 Defined liquidation process

As mentioned above, each of the compartments of a securitisation company can be liquidated separately (by a simple board resolution) without any negative impact on the vehicle's remaining compartments, i.e. without triggering the liquidation of other compartments or the company itself (while the liquidation of the last sub-fund of a securitisation fund would entail the securitisation fund's liquidation). Usually, a securitisation vehicle is voluntarily liquidated once its transaction matures and all obligations have been repaid, except if it is again used for another transaction. In Luxembourg, there are two different procedures for the standard voluntary liquidation of a company (not specific to securitisation vehicles): a normal procedure and a simplified procedure (for vehicles with a single shareholder[1]).

Within the normal liquidation procedure as illustrated in Figure 17, liquidation is performed in three steps: a first extraordinary general meeting of the shareholders ("EGM") takes the decision to dissolve the company and appoints a liquidator. The company now has to indicate in its documents that it is "in liquidation". The liquidator is responsible for preparing a detailed inventory of the vehicle's assets and liabilities, realising the assets, paying the debts and distributing the remaining balance (if any) to the creditors or other appropriate parties.

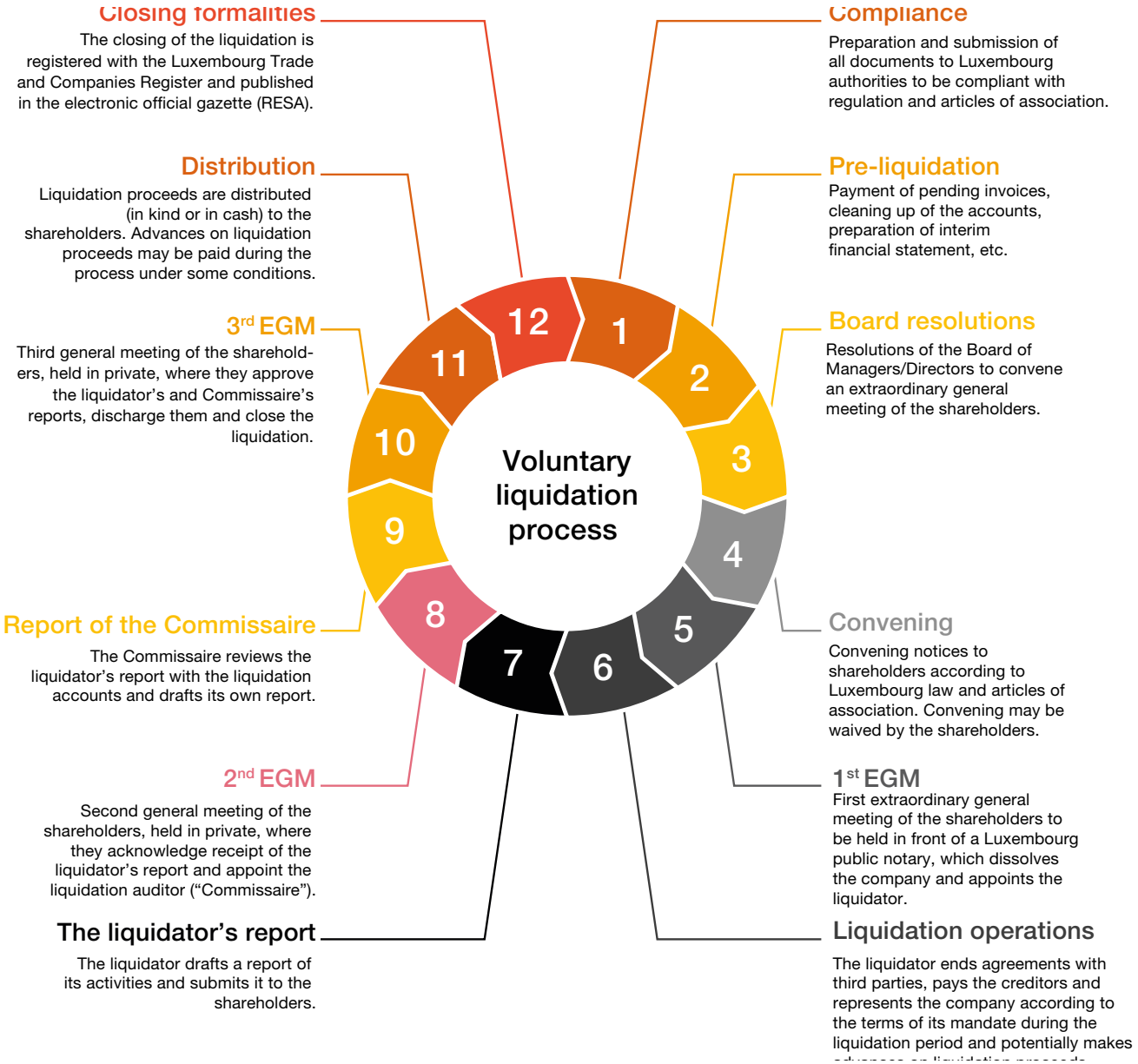
After completion of the liquidation, the liquidator presents a report to the shareholders in a second EGM, which also appoints an auditor as "Commissaire à la liquidation". The Commissaire à la liquidation reviews the work performed by the liquidator and prepares a report for the attention of the shareholders in a third EGM which then finally decides on the dissolution of the company.

For a simplified liquidation to be applicable, all shares must be held by a sole shareholder. Furthermore, certain certificates from the Central Social Security Office, the direct tax administration, and the registration tax and VAT administration must be obtained. Such certificates must confirm that the company is in compliance with its obligations to these bodies. The sole shareholder may then resolve to dissolve the company without liquidation and all assets and liabilities of the company will be transferred to him.

If the vehicle is supervised by the CSSF, the liquidators must be authorised by the CSSF and have the necessary good repute and professional qualifications, and the liquidation is subject to CSSF supervision.

[1] Art. 1100-1 (2) of the Luxembourg Commercial Law.

Figure 17: Liquidation process of a Luxembourg company



4

Accounting aspects

4.1 Accounting - LuxGAAP

The Luxembourg Securitisation Law itself does not contain any provisions with respect to specific topics, e.g. accounting principles. Instead, it refers to other laws depending on the legal form of the securitisation vehicle (an overview is shown in Figure 18). In addition to these, further industry practices have been developed.

4.1.1 Securitisation company accounting

General accounting framework

Securitisation vehicles established as securitisation companies (including the new partnership forms) must comply with the provisions of chapters II and IV of title II of the Law of 19 December 2002 on the trade and companies register and the accounting and the annual accounts of companies, as amended (hereafter the "Accounting Law"). The Accounting Law sets the legal framework for the accounting principles applied to Luxembourg companies, the Luxembourg Generally Accepted Accounting Principles ("LuxGAAP").

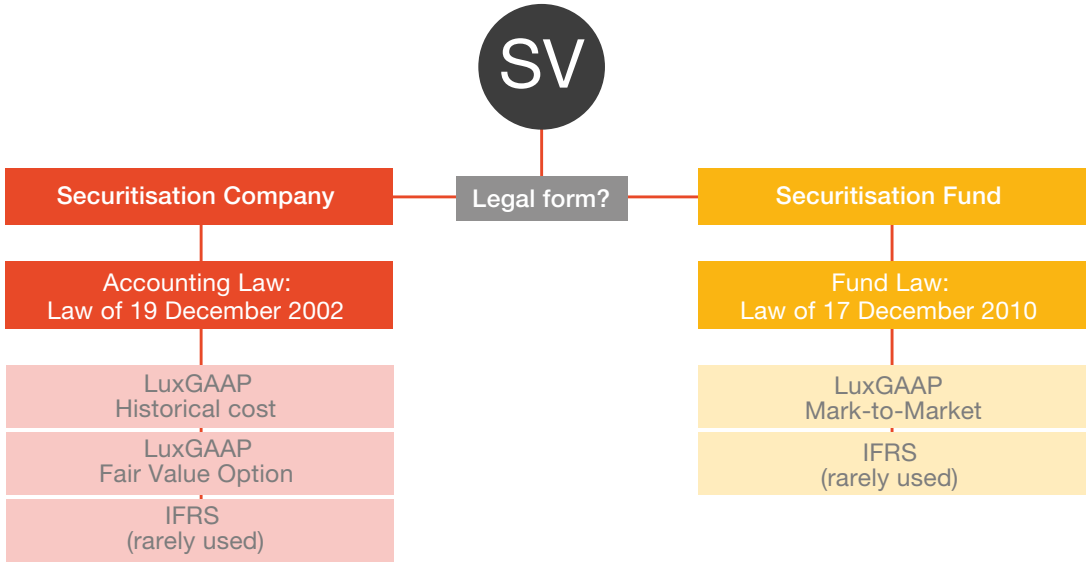
The Luxembourg Securitisation Law also prescribes the application of the Accounting Law for partnership forms (SNC, SCS, SCSp) which are normally not in scope of the Accounting Law.

An interesting feature for securitisation companies, which mainly invest in financial instruments, is the flexibility that LuxGAAP offers to the preparers of annual accounts. The Accounting Law provides a choice between different accounting frameworks: (i) LuxGAAP under the historical cost model, (ii) LuxGAAP under the fair value option or (iii) International Financial Reporting Standards ("IFRS") as adopted by the European Union. Further guidance on LuxGAAP accounting and disclosure can be found in our publication **Securitisation in Luxembourg - Illustrative financial statements**.

Under LuxGAAP (historical cost model), a securitisation company's assets are valued either at their acquisition cost or at the lower value attributed to them. Under the historical cost convention, a valuation above the acquisition cost, e.g. based on higher market values, is generally not acceptable. However, when the value attributed to a fixed asset is lower than the acquisition cost, a value adjustment must be made for any durable value depreciation ("cost less impairment"). An accounting policy choice may also be made to recognise a value adjustment for any such decrease in value ("lower of cost or market value" or "LOCOM").

In addition, LuxGAAP offers the possibility to value most financial instruments at fair value without being subject to further provisions of the IFRS (fair value option). Nevertheless, some additional disclosure on the fair value instruments and valuation models, if any, must be presented in the notes to the annual accounts. For some instruments, e.g. investments in subsidiaries and associates and some non-financial assets, the fair value option can only be applied when complying with the full valuation and disclosure requirements of the relevant IFRS standards. The fair value option is often chosen when the repayable amount of the financial instruments issued directly depends on the fair value of derivatives or fund investments held as investments.

Figure 18: Luxembourg Accounting flexibility



reporting.

Securitisation companies having issued transferable securities that are listed on an EU-regulated market (so-called "EU-Public Interest Entities" or "EU-PIE") may also have to comply with further disclosure requirements pursuant to the Transparency Directive and/or the Prospectus Regulation. For example, the Prospectus Regulation requires the financial information to contain a cash flow statement, which may have to be added to the annual accounts under LuxGAAP. However, the stand-alone financial information may still be prepared according to national accounting standards, i.e. LuxGAAP. An obligation to use IFRS in this context exists only for consolidated financial statements, which a securitisation vehicle would usually not have to prepare.

Furthermore, an EU-PIE has to follow a specific filing format called European Single Electronic Format or ESEF if it cannot benefit from certain exemptions (please refer to section 4 for further detail).

4.1.2 Securitisation fund accounting

A securitisation fund managed by a management company and governed by management regulations is subject to the accounting and tax regulations (except for the annual subscription tax) applicable to undertakings for collective investments ("UCIs") provided by the Law of 17 December 2010 on undertakings for collective investment, as amended (the "Fund Law"). The Luxembourg Securitisation Law does not refer to specific articles in the Fund Law but our understanding is that provisions related to recognition, measurement and disclosure should be read as "accounting regulations".

This implies valuation of assets on the basis of the last known representative stock exchange quotation or the most probable realisation value estimated with care and in good faith, i.e. a fair market valuation, unless otherwise stated in the management regulations. Thus, fair valuation is the default option but can be overridden by the management regulations,

e.g. prescribing the use of historical cost or other valuation models.

The layout of the annual and the semi-annual report would be based on Article 151 (3) and (4) of the Fund Law, thus containing:

- a balance sheet or a statement of assets and liabilities,
- a detailed income and expenditure account for the financial year,
- a report on the activities of the past financial year,
- the other information provided for in Schedule B of Annex I of the Fund Law (e.g. net asset value per unit and units in circulation; analysis of the asset portfolio by economic, geographical, currency or other appropriate criteria), and
- any significant information necessary for investors' judgement on the development of the activities and the results of the fund.

4.1.3 Accounting for fiduciary estates

As mentioned above, a securitisation company or a securitisation management company may also act as a fiduciary and issue notes on a fiduciary basis in its own name but at the sole risk and for the exclusive benefit of the noteholder. Therefore, the fiduciary assets and liabilities do not constitute assets or obligations of the securitisation vehicle itself but need to be shown segregated from all other assets of the fiduciary (i.e. the securitisation (management) company) as well as from other fiduciary estates.

Consequently, the fiduciary transactions are recorded off-balance sheet by the securitisation (management) company. In our view, in order to meet the information function of the annual accounts, an investor in a fiduciary estate should receive the same information as an investor in a compartment, both being exposed to the risks and rewards of the underlying assets. Therefore, we highly recommend to provide a similar level of disclosure in the notes to the annual

In our separate publication "Illustrative financial statements" within our series "Securitisation in Luxembourg", we present an example of the financial statements of a securitisation fund.

accounts regarding the fiduciary estates as if the transaction would have been recorded on-balance sheet. This enables the annual accounts to provide sufficient information to investors on the situation of their (fiduciary) investment. For example, a dedicated note describing the investments and related liabilities as well as the directly linked income and charges of each fiduciary estate should be disclosed. More detailed information of other assets/liabilities or income/charges positions may not be necessary depending on their significance.

4.1.4 Accounting for multi-compartment vehicles

One of the distinctive features of Luxembourg's asset management industry – the possibility to create sub-funds – was also included in the Luxembourg Securitisation Law and provides securitisation vehicles with the possibility to segregate the assets and liabilities into one or more separate compartments or subfunds, each corresponding to a distinct part of its assets financed by distinct financial instruments. The Luxembourg Securitisation Law provides legal certainty that the compartment's assets are available exclusively to satisfy the rights of investors in relation to this compartment as well asthe rights of creditors whose claims have arisen in connection with the creation, operation or liquidation of that compartment.

As far as accounting is concerned, the CSSF confirmed that multi-compartment securitisation companies should present their annual accounts and related notes to the annual accounts in such a way that the financial data for each compartment is clearly stated. It is possible, however, to combine the notes to the annual accounts of several compartments. As a result, for accounting purposes, a securitisation vehicle with several compartments is regarded as a combination of several "companies" under the umbrella of one legal entity. In order to achieve a true and fair view of a multi-compartment securitisation vehicle's activities and financial position, it is required to provide (and consequently audit) information on compartment level, and not only a combined balance sheet and a combined profit and loss account.

In practice, separate balance sheets and profit and loss accounts for each compartment are disclosed as part of the notes to the annual accounts. Alternatively, the notes to each asset, liability, income and charges position should give sufficient detail per compartment. The accounting has to be prepared in a way that such asset, liability, income and charges position of each compartment can be extracted separately, i.e. using a separate general ledger per compartment in the bookkeeping system. In our publication "Illustrative financial statements" within our series "Securitisation in Luxembourg", we present an example of the annual accounts of a securitisation company, including an example of how to meet the disclosure requirements for a multi-compartment structure. The same applies for a securitisation fund with several sub-funds.

Under certain circumstances, an additional separate audit opinion can be expressed on parts of the securitisation vehicle's annual accounts (e.g. for one compartment only). However, this does not prevent the securitisation vehicle from complying with the legal obligation to prepare and publish audited annual accounts for the entity as a whole (including information on all of its compartments).

4.1.5 Treatment of (unrealised) gains and losses for the security holders ("equalisation provision")

From the investors' perspective, the securitisation vehicle is bankruptcy remote. A bankruptcy remote structure provides reasonable certainty that the financial instruments issued are collateralised by a pool of assets that have been legally isolated from the transferor in all possible circumstances, including insolvency. Therefore, no recourse can be made by the

Further explanation should be given in the notes to the annual accounts. Our publication "Securitisation in Luxembourg - Illustrative financial statements" provides an example for a possible disclosure.

transferor's creditors or liquidator to the securitisation vehicle's assets.

On the other hand, the recovery of the financial instruments issued is entirely dependent on the securitisation vehicle's asset pool generating sufficient cash flow, as the investors have no recourse to the transferor beyond its structural support, should the asset cash flow be less than originally expected. The repayable amount of the financial instruments issued is thus not a fixed amount but directly depending on the value or cash flow of the securitised risks or assets.

The investor's risk is often managed by the structuring of the cash flows of the securitisation vehicle and financial instruments issued. This is most typically achieved by issuing at least one senior and one subordinated financial instrument , each having a different seniority with regards to payment from the cash flow of the pool of assets (so-called "tranching"). When the cash flow from the asset pool is collected, it is firstly used to meet the obligations of the most senior ranked investors. Any residual cash flow after payment of the most senior class is then used to pay the less senior investors. This mechanism is known as "waterfall" or "priority of payments" and has the effect of allocating potential cash flow shortfalls to the most junior investors and, on the other hand, enhancing the credit quality for the senior investors (see Section 2.1).

This implies that any recognised value decrease of the assets (impairment or fair value loss) will be borne by the holders of the financial instruments issued through a reduced repayable amount . This variation in the repayable amount[1] of the financial instruments issued based on the direct asset link is, for Luxembourg securitisation vehicles and as a best practice, immediately reflected in accounting and referred to as "equalisation provision" (see Figure 19). This value adjustment of the repayable amount has to be clearly disclosed in the notes to the annual accounts (a reduced repayment obligation would result in a gain for the securitisation vehicle). As a result (and not per se for securitisation vehicles), the total net effect on the profit and loss account will often be close to nil. The equalisation provision should not be confused with a write-off of the repayment obligation resulting from the financial instrument issued; the obligation remains based on the notional and the repayment formula or waterfall; only the estimated repayable amount changes.

To enable a better understanding for the reader of the annual accounts, a description of the valuation method used to calculate the equalisation provision should be given in the notes to the annual accounts as well as a summary of the waterfall structure.

The reverse effect applies when the repayable amount of the financial instruments issued increases as a consequence of an increase in asset value. A securitisation vehicle is usually bound by agreements to distribute all the cash flows received to the investors (e.g. as variable interest or as an increased repayable amount) or to other involved parties (e.g. arranger), but not necessarily in the same period in which the profit takes place. Nevertheless, the liability for the increased payment obligation already incurred and thus a higher reimbursement value must be shown in the annual accounts.

However, neither Accounting Law nor electronic annual accounts filing formats ("eCDF") foresee a caption called "equalisation provision". Therefore, it has become market practice to directly deduct or add the total equalisation provision from the financial instruments value and to disclose the effects in the profit and loss account under "other operating income" and "other operating charges" respectively (as it is the consequence of the securitisation vehicles activity rather than an interest charge).

4.1.6 Legal reserve/subscribed capital for compartments

Another regular question, especially for equity financed

[1] Sometimes an additional subordinated loan might be granted to serve as credit enhancement by the arranger or the originator, which would then bear the first losses.

securitisation companies, concerns the treatment of the legal reserve within a multi-compartment securitisation company (not applicable for securitisation funds). Neither Accounting nor Commercial Law provide detailed guidance on this as a multi-compartment structure is a specificity of the Luxembourg Securitisation Law and not further covered by Accounting and Commercial Law.

In general, the Commercial Law states in Articles 461-1 and 710-23 that a company is required to allocate a minimum of 5% of its annual net profit to a legal reserve, until this reserve equals 10% of the subscribed share capital.

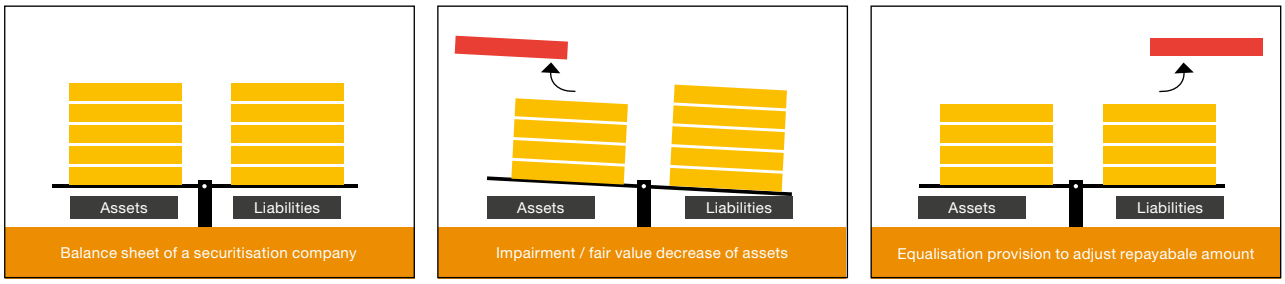
As most of the securitisation companies in Luxembourg are financed by debt and do not make any profit, a legal reserve will not be built up. However, equity-financed structures or securitisation transactions leaving a profit margin in the company would have to allocate a legal reserve until it reaches 10% of the subscribed capital of the company.

In prior years, this created some confusion for equity financed multi-compartment vehicles as the compartments are fully segregated from each other but the overall result of the company equals the total of all profits and losses of the compartments. Not only was the allocation of the legal reserve concerned but also the possibility to distribute profits from the profit-making compartments. With the modernisation of the Luxembourg Securitisation Law in 2022, this has been clarified. Now, the treatment and distribution of profits and losses of equity financed compartments is clearly defined stating that this has to be done on a compartment basis. Consequently, profit-making compartments that are financed by equity and, therefore, disclosing compartments' subscribed capital must allocate at least 5% of the net profit to the legal reserve until reaching 10% of the compartments' subscribed capital.

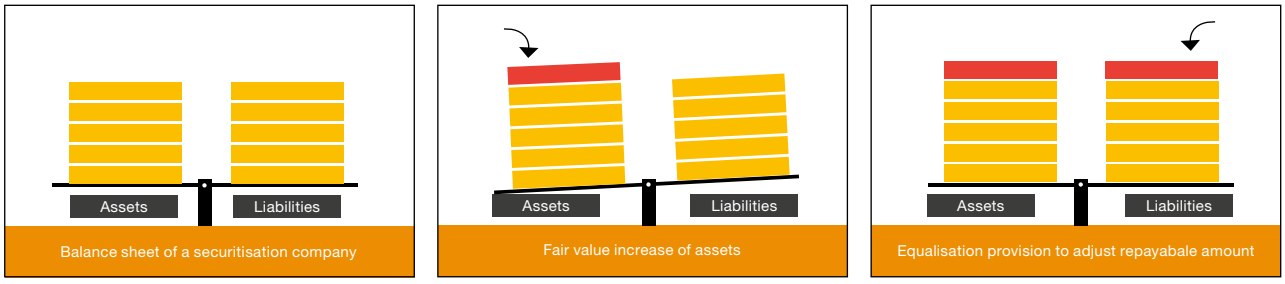
An example of an equity financed three-compartment vehicle is outlined in Figure 20 below. This example illustrates that, although the company is in total (i.e. in its combined figures) in a loss position, the profit-making compartments need to allocate

Figure 19: Illustration of equalisation provision concept

a. Decrease of asset value and corresponding repayable amount of the financing instrument



b. Increase of asset value and corresponding repayable amount of the financing instrument



part of their profits to a legal reserve. In addition, compartments 1 and 3 are able to distribute a dividend after allocation to legal reserves of EUR 9,500 and EUR 4,750 respectively to their shareholders, given that the distribution is adequately approved by the general meeting of the shareholders of the compartment. In this context, it is important to clearly define, for example in the articles of incorporation, that only the shareholders of a respective compartment can decide on a dividend distribution of that compartment and not on other compartments.

Figure 20: Legal reserve - example

Compartment	Subscribed capital	Result of the year	Allocation to legal reserve
1	EUR 100,000	EUR 10,000	EUR 500
2	EUR 200,000	EUR (20,000)	EUR 0
3	EUR 100,000	EUR 5,000	EUR 250
Combined	EUR 400,000	EUR (5,000)	EUR 750

4.1.7 Standard Chart of Accounts, electronic filing and European Single Electronic Format

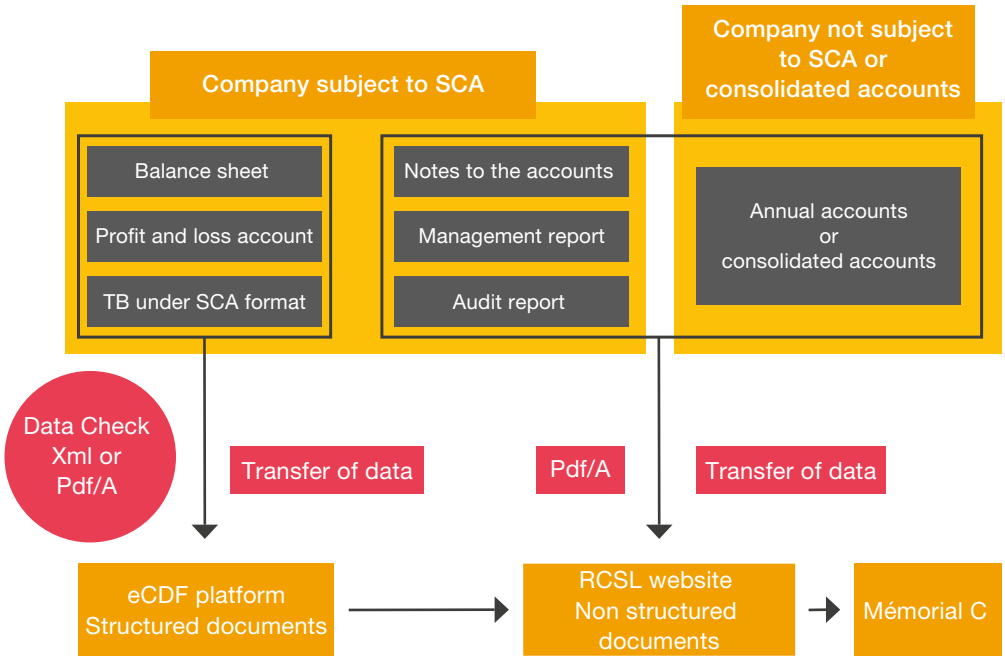
In Luxembourg, legislation prescribes the use of a Standard Chart of Accounts ("SCA") and eCDF for most companies. All securitisation companies that do not fall under CSSF supervision are, among other companies, obliged to use SCA and eCDF (not applicable for securitisation funds). The modernised Luxembourg Securitisation Law as lex specialis makes it clear that this shall also apply to securitisation vehicles in partnership form (SNC, SCS, SCSp). Companies that prepare and publish their annual accounts under IFRS are exempted from filing their trial balance and annual accounts under the SCA and the eCDF respectively.

For the annual accounts of multi-compartment vehicles, best practice is to present a combined balance sheet and combined profit and loss account in the eCDF format and additionally, to disclose a separate balance sheet and profit and loss account for each compartment (or similar compartment-specific information) as part of the notes to the annual accounts, which would not be in eCDF format.

As per Article 75 of the Accounting Law, all Luxembourg-based companies are required to file their annual accounts with the Luxembourg trade and company register ("RCSL") electronically as illustrated in Figure 21. Since the audit of a securitisation vehicle is a legal obligation, the audit report needs to be filed together with the annual accounts.

Since financial periods beginning on or after 1 January 2021, Luxembourg companies having securities issued (equity or debt) admitted to trading on an EU-regulated market have to prepare their annual financial reports using the European Single Electronic Format ("ESEF") if no exemption applies. Companies have to prepare one single file in XHTML (webpage) format that includes financial statements, management report (incl. corporate governance statement) and responsibility statement. The aim is to enhance comparability and usability of financial information. Issuers that exclusively have debt securities admitted to trading on an EU-regulated market with a denomination per unit of at least EUR 100,000 are exempted from this requirement. In addition, issuers preparing IFRS consolidated financial statements have to fulfil certain tagging or mark up requirements using iXBRL.

Figure 21: e-filing procedure



4.2 Accounting - IFRS

Accounting based on International Financial Reporting Standards ("IFRS") is important for some Luxembourg securitisation vehicles, but the vast majority still uses LuxGAAP or LuxGAAP under fair value option for preparing their mandatory stand-alone financial statements.

Some securitisation vehicles opt to prepare their stand-alone financial statements under IFRS, which is an option in the Luxembourg Accounting Law. In addition, other securitisation vehicles become part of a consolidation group, which prepares its financial statements under IFRS or have investors requiring financial reporting under international standards. In such cases, the securitisation vehicle does usually not prepare a full set of financial statements under IFRS, but a dedicated reporting package applying only the relevant IFRS requirements.

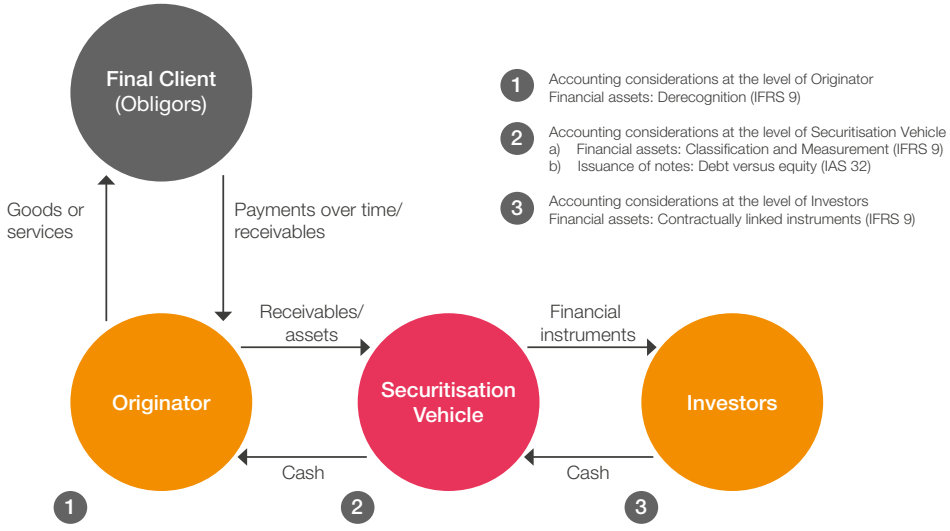
Due to the nature of the securitisation business, the assets of the securitisation vehicle mainly comprise financial instruments while the liabilities are formed of financial instruments issued. Therefore, we have highlighted below the key challenges the securitisation vehicle (or another involved party) may face when preparing IFRS accounts. Due to the nature of the assets and liabilities, i.e. being financial instruments, accounting is mainly covered by IFRS 9.

Consolidation requirements are derived from IFRS 10.

The purpose of this section is to give a first guidance on what may be the most relevant factors in the context of a securitisation transaction; it shall not be seen as a detailed commentary on IFRS 9, IFRS 10, or IFRS as a whole.

The IFRS accounting considerations largely depend on the role the preparer of financial statements has in a securitisation transaction (see Figure 22).

Figure 22: Different accounting considerations for the different actors



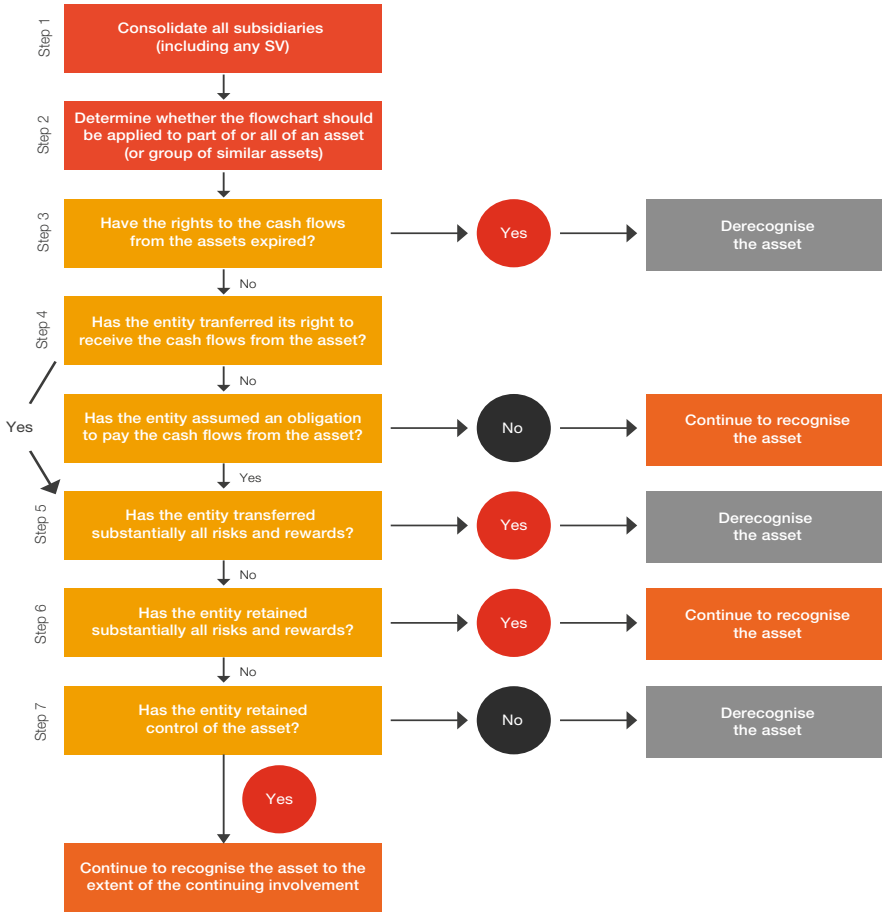
4.2.1 Originator - Derecognition of financial assets

One of the challenges faced by the originator or an objective he may want to achieve is the ability to derecognise the securitised assets from his balance sheet. The rules on derecognition of financial instruments under IFRS are defined in IFRS 9 and summarised in Figure 23 below.

When transferring their assets to a securitisation vehicle in order to derecognise them from their own balance sheet, originators need to pay attention to:

- credit enhancements provided to the securitisation vehicle (e.g. subordinated retained interests, credit guarantee, total return swap with transferee, excess spread, etc.); and
- continuing involvement in transferred assets (e.g. full or partial guarantees of the collectability of receivables, conditional or unconditional agreements to re-acquire the transferred assets, written or held options, retained servicing depending on fee, etc.).

Figure 23: Rules of derecognition under IFRS 9



4.2.2 Securitisation vehicle - Financial assets and liabilities

a) Financial assets – classification and measurement

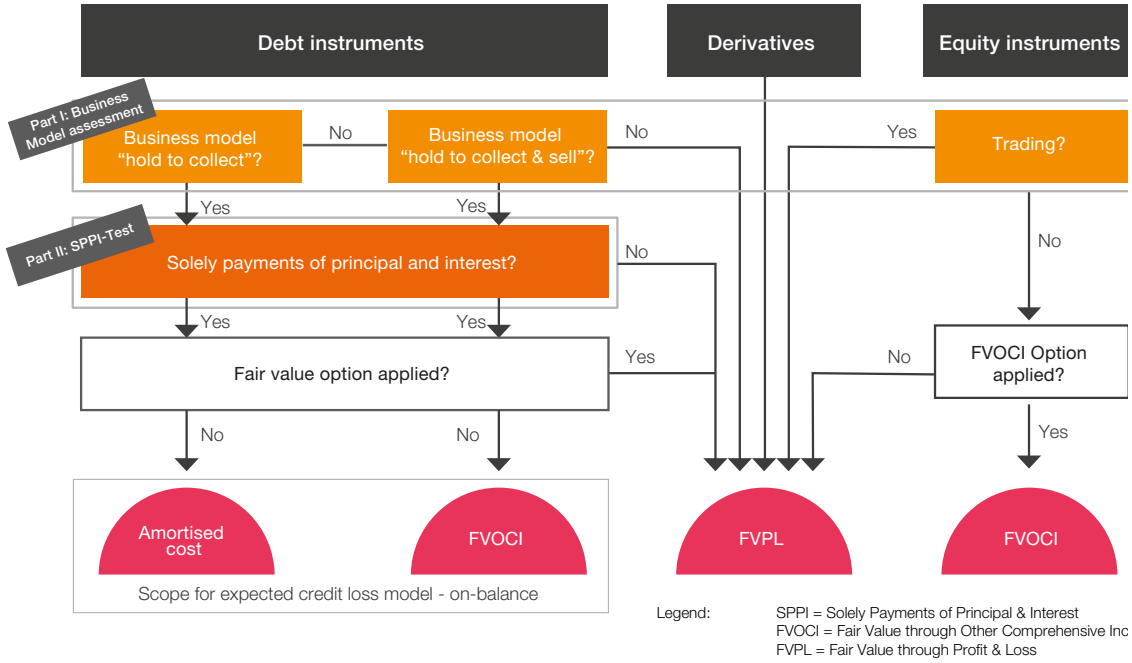
Initial recognition

IFRS 9 - Financial instruments represents an important step of alignment between accounting and business practice. Classification and measurement of financial assets are assessed based on the instrument's nature (debt or equity), features (characteristics of contractual cash flows), and underlying business model (how an entity manages its financial assets to generate cash flows and create value for the entity). This is summarised in Figure 24.

For debt instruments, there are three defined classification categories:

- Amortised cost ("AC"), when contractual cash flows represent solely payments of principal and interest ("SPPI") and the entity's business model is "hold to collect" (mainly collecting the contractual cash flows);
- Fair value through other comprehensive income ("FVOCI"), when contractual cash flows are SPPI and the entity's business model is "hold to collect and sell" (a mix model of collecting the contractual cash flows and realising capital gains through sells); and
- Fair value through profit or loss ("FVPL"), the residual category.

Figure 24: Overview of financial asset classification under IFRS 9



Investments in equity instruments are always measured at fair value. However, in order to reduce the volatility of the profit and loss account ("P&L"), the entity can make an irrevocable election on an instrument-by-instrument basis to present changes in fair value in other comprehensive income ("OCI"), provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value must be affected to P&L.

For designated equity instruments at fair value in OCI there is no recycling of amounts from OCI to P&L – for example, on sale of an equity investment – nor are there any impairment requirements.

Expected credit loss model

Debt instruments classified at "Amortised cost" and "Fair value through other comprehensive income", as well as lease receivables, contract assets, as well as for loan commitments, and financial guarantees not measured at fair value are subject to impairment loss assessment.

IFRS 9 introduced a model for the recognition of impairment losses – the expected credit losses ("ECL") model. The ECL model seeks to address the criticisms of the incurred loss model that arose during the economic crisis and to better incorporate the information needs of investors.

In practice, the new rules mean that entities will have to record a day 1 loss based on the probability of assets to default in the next 12 months. The impairment assessment under IFRS 9 also considers the change in credit quality of financial assets since initial recognition which is divided in three stages: (i) materially unchanged credit risk, (ii) significantly increased credit risk, (iii) objective evidence of impairment. A significant increase in the credit risk of assets will further trigger a higher provisioning (for the lifetime expectation of default).

A simplified approach is used for trade receivables, lease receivables and contract assets that result from transactions that are within the scope of IFRS 15 without significant financing component, and it can be used for trade receivables and contract assets with significant financing component as well as for lease receivables.

IFRS 9 establishes a simplified impairment approach for qualifying trade receivables, contract assets within the scope of IFRS 15 and lease receivables (see Figure 25 below). For these assets a securitisation structure can, or in one case must, recognise a loss allowance based on lifetime ECLs rather than the two step process under the general approach.

Some securitisation structures were designed to hold portfolios of distressed loans. Such instruments are bought at a substantial discount from their nominal value, as most of the loans are not performing. If the vehicle intends to hold the loans to collect the contractual cash flows, and not to sell, the business model is "hold to collect".

Figure 25: Scope of the simplified approach

Trade receivables and contract assets within the scope of IFRS 15	Basis of application
Do not contain a significant financing component, or the entity applies the practical expedient to measure the asset at the transaction price under IFRS 15	Mandatory
Contains a significant financing component	Policy choice
Lease receivables	
Finance leases	Policy choice
Operating leases	Policy choice
An entity may select its accounting policy for trade receivables, lease receivables and contract assets independently of one another	

The general impairment model does not apply to purchased or originated credit-impaired assets. A financial asset is considered credit-impaired on purchase or origination if there is evidence of impairment at the point of initial recognition. Impairment is determined based on full lifetime ECL on initial recognition for purchased or originated credit-impaired financial assets. Lifetime ECL are included in the estimated cash flows when calculating the effective interest rate on initial recognition. The effective interest rate for interest recognition throughout the life of the asset is a credit-adjusted effective interest rate. As a result, no loss allowance is recognised on initial recognition. Any subsequent changes in lifetime ECL, both positive and negative, will be recognised immediately in the income statement, even if the lifetime ECL are less than the amount of ECL that was included in the estimated cash flows on initial recognition.

To enhance the comparability of financial assets that are credit-impaired on initial recognition with those that are not, an entity shall disclose the total amount of undiscounted expected credit losses at initial recognition on financial assets that are purchased or originated credit-impaired initially recognised during the reporting period. Such disclosure allows us to see the possible contractual cash flows that an entity could collect if there was a favourable change in expectations of credit losses for such assets.

b) Financial liabilities – classification and measurement

Initial recognition

IFRS 9 foresees two categories for financial liabilities:

- Fair value through profit or loss, if held for trading or designated upon initial recognition. Such designation is permitted if it eliminates an accounting mismatch or a group of financial liabilities (and assets) is managed and its performance is evaluated on a fair value basis. For designated liabilities, the movement in fair value due to the deterioration of its own credit risk is to be recognised in OCI, so that P&L is impacted only by appropriate components of movements in fair value.
- Amortised cost, residual category

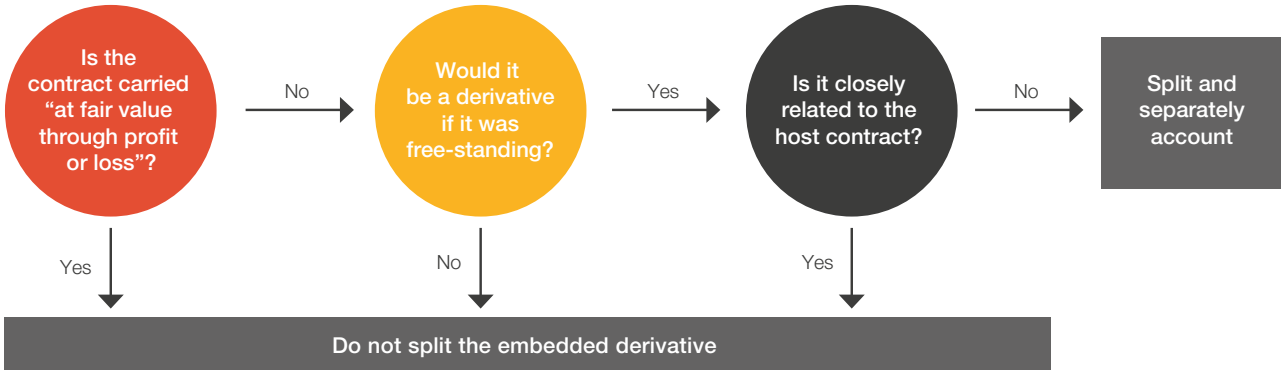
Debt versus equity

Securitisation vehicles are issuing financial instruments that have particular features to satisfy the investors' needs in terms of desired level of risk and returns. Under IFRS, such features might affect classification between debt and equity. IAS 32 – Financial instruments: Presentation contains the principles for distinguishing between financial liabilities and equity.

A contractual agreement's substance takes precedence, resulting in some situations where instruments that qualify as equity for regulatory, tax or legal purposes, on closer examination, are financial liabilities for reporting purposes. Contractual features that lack substance are not to be considered regardless of whether such features would significantly affect the classification. These aspects might be attractive for investors.

Other features such as interest/dividend payments triggered/conditioned by other classes of instruments have to be closely considered as they might have an impact on assessing if an instrument is debt or equity or components of such instruments have different classifications.

Figure 26: Treatment of derivatives embedded in financial liabilities under IFRS 9



Embedded derivatives

There might be embedded call, put, or pre-payment options in the financial instruments issued by securitisation vehicles. In general, such options are not closely related to the debt host as they relate to factors other than interest rate risk and credit risk of the issuer. However, there might be situations in which, after a close analysis, the conclusion imposes itself that they are closely related (and therefore no need of split accounting/ bifurcation), if the exercise price of the call/put is approximately equal, on each exercise date, to the host debt instrument's amortised cost; or the exercise price of the prepayment option reimburses the holder for lost interest for the host contract's remaining term

Interest and principal payments that are linked to an equity index are not closely related to the debt host contract, unless the index is a non-financial variable specific to the entity. Close attention needs to be paid to these aspects, if the securitisation vehicle is providing structured products.

If the securitisation vehicle issues convertible bonds, the equity conversion option is an equity instrument for the issuer provided that it meets the conditions for equity classification under IAS 32. This embedded derivative is not closely related and the securitisation vehicle would have to separate the embedded derivative from the host contract (the note itself). A decision tree is illustrated in Figure 26.

c) Disclosure requirements

IFRS requirements in terms of disclosures were designed to provide useful information to investors and other financial statement users, such as:

- significance of financial instruments in relation to an entity's financial position and performance;
- nature and extent of risks arising from financial instruments to which the entity is exposed (i.e. market risk, liquidity risk, credit risk) and how these risks are managed;
- fair value measurement hierarchy. These disclosure requirements are also partly applicable under LuxGAAP if the fair value option described in Section 4.1.1 is used.

4.2.3 Investors - Look-through approach

Contractually linked instruments

In a securitisation transaction, the risk of a pool of assets in which the structured entity is investing is passed to investors through particular features of instruments issued like "tranching". The degree and extent to which the cash flows of the debt instruments issued are modified to incorporate the exposure to specific risks of the underlying assets varies upon the seniority of tranches. Furthermore, more senior tranches are repaid in priority to the more junior ones from collections made on the related pool of assets.

Under IFRS, such instruments are called "contractually linked instruments". Investors holding these types of instruments have the right to payments of principal and interest on the principal amount outstanding only if the issuer generates sufficient cash flows to satisfy any higher-ranking tranches.

Accounting-wise, the classification and implicitly the measurement criteria for the holder of these tranches should be assessed by using a "look through" approach. This approach looks at the terms of the instrument itself, as well as through to the pool of underlying instruments. The assessment considers both the characteristics of these underlying instruments and the tranche's exposure to credit risk relative to the pool of underlying instruments.

Non-recourse assets

Financial instruments issued by a securitisation vehicle usually include a non-recourse provision, i.e. an agreement that, if the securitisation vehicle (or one of its compartments) defaults on the secured obligation, the investor can look only to the securing assets (whether financial or non-financial) to recover its claim. The investor has no legal recourse against the securitisation vehicle's other assets.

The fact that a financial asset is non-recourse does not necessarily preclude the financial asset from meeting the SPPI criterion (see Section 4.2.2). However, the investor is required to assess (that is, to "look through to") the particular underlying assets or cash flows to determine whether the financial asset's contractual cash flows are SPPI. If the instrument's terms give rise to any other cash flows, or if they limit the cash flows in a manner that is inconsistent with the SPPI criterion, the instrument will be measured in its entirety at FVTPL.

Following the post implementation review (PIR) of IFRS 9, guidance on contractually linked instruments and non-recourse financial assets is expected to be updated.

4.2.4 Consolidation of securitisation vehicles

At the level of the originators and the investors

In the context of a securitisation transaction, IFRS may oblige one of the involved parties to consolidate the assets and liabilities of the securitisation vehicle as investee. The consolidation considerations may affect both the originators and the investors. From an accounting perspective, one question needs to be addressed: who of the originator(s) or investor(s) controls the investee, and therefore has to consolidate it in its consolidated financial statements[1]? It is also possible that the result of such analysis concludes that nobody controls the securitisation vehicle; in that case, it remains stand-alone.

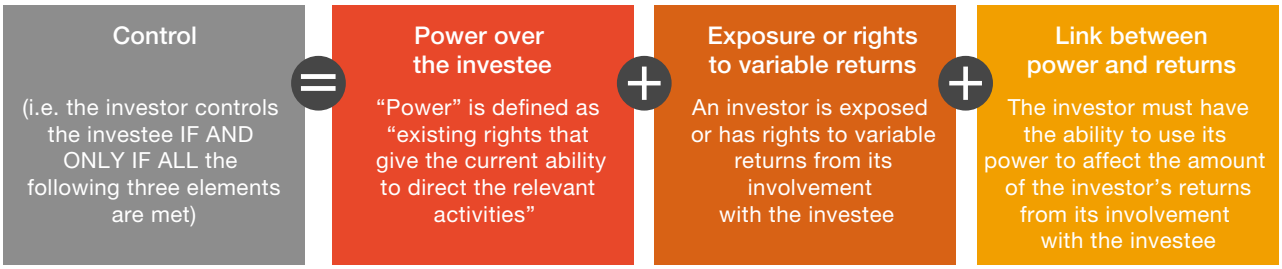
The answer to this question has major consequences, as the entity consolidating the securitisation vehicle will disclose in its consolidated financial statements the assets and liabilities held by the securitisation vehicle.

Consolidation – general considerations

The guidance regarding control is provided by IFRS 10 – Consolidated Financial Statements. However, a securitisation transaction does not have the same characteristics of a standard group (defined as "parent and its subsidiaries"). A securitisation vehicle is considered a structured entity, as it fulfils (some or all) the following features or attributes as described in IFRS 12 – Disclosure of interests in other entities

- Restricted activities.
- A narrow and well defined objective, such as:
  - » to effect a specific structure like a tax efficient lease;
  - » to perform research and development activities; or
  - » to provide a source of capital or funding to an entity or to provide investment opportunities for investors by passing risks and rewards associated with the assets of the structured entity to investors.
- Thin capitalisation, i.e. the proportion of "real" equity is too small to support the structured entity's overall activities without subordinated financial support.
- Financing in the form of multiple contractually linked instruments to investors that create concentrations of credit risk or other risks (tranches).

Figure 27: Consolidation requirements under IFRS 10



[1] Reference to investee in this section corresponds to the securitisation vehicle, and investors to the originator or the investor.

Although having different and specific characteristics, the assessment of who controls a structured entity is determined using the same framework of IFRS 10, i.e. someone "controls" the SV. This means, cumulatively, (i) having power over the investee, (ii) having exposure or rights to variable returns, and (iii) having a link between power and returns (see Figure 27). This all means that the following indicators need to be considered when assessing control:

- The purpose and design of the structured entity;
- What the relevant activities are;
- How decisions about these activities are made;
- Whether the rights of the investor give it the current ability to direct the relevant activities;
- Whether the investor is exposed, or has rights, to variable returns from its involvement with the investee;
- Whether the investor has the ability to use its power over the investee to affect the amount of the investor's returns.

Nevertheless, there is a key difference regarding structured entities: often, the voting or similar rights are not the means by which it is controlled; rather the relevant activities of the structured entity are directed by means of contractual arrangements. If these contracts are tightly drawn, it may appear that none of the parties has power. In cases for which a detailed analysis leads to this conclusion, there is no party to consolidate the structured entity

IFRS 10 provides a wide range of other factors to consider when the control situation remains unclear after considering all the above factors. These include non-contractual powers and "special relationships". The key is to ensure that a holistic assessment of all relevant facts and circumstances is carried out. These factors should be considered in aggregate. Not all the factors need to be satisfied for an investor to have power. However, it also does not mean that satisfying any one of these factors will always be sufficient.

Consolidation - Silos (Compartments)

Another important consideration in relation to securitisation vehicles is the potential for the existence of silos. Silos consist of specific assets and liabilities of an entity that might, in certain circumstances, be ring-fenced from the entity's other assets and liabilities. A silo typically has no separate legal entity, but consists of a portfolio of assets and liabilities that are contractually separated from (and do not share risk with) other assets and liabilities in the same legal entity. In practice, silos can be set up to provide other financial benefits to the investors in such structures. The assets of each individual silo are not available to the creditors of any other part of the same entity. A compartment of a Luxembourg securitisation vehicle perfectly matches this definition and would usually be treated as "silo" under IFRS.

Where the conditions set out below are met, the silo is viewed as a "deemed separate entity" for the purpose of applying IFRS 10 – that is, an investor in the silo assesses whether it has control of the silo rather than assessing control at the level of the broader legal entity. This can result in the originator or the investor consolidating only a part of the securitisation vehicle.

IFRS 10 contains guidance for identifying when a silo should be accounted for as a deemed separate entity, from a consolidation perspective. It states that an investor should treat a portion of an investee (i.e. a silo) as a deemed separate entity only if the following conditions are satisfied:

- The investee's specified assets (and any related credit enhancements) are the only source of payment for specified liabilities of, or specified other interests in, the investee;
- Parties other than the investee with the specified liability do not have rights or obligations related to the investee's specified assets or to residual cash flows from those assets;
- In substance, none of the returns from the investee's specified assets can be used by any remaining investee, and none of the liabilities of the deemed separate entity are payable from the assets of any remaining investee;
- In substance, all of the assets, liabilities, and equity of the deemed separate entity are ring-fenced from other investors

If it is concluded that the investor has control, it should consolidate the silo. The other investors in the entity will then need to exclude that portion of the investee in their own assessment of control.

The exception to consolidation: Investment entity

Assuming that the analysis conducted to the conclusion that a certain securitisation vehicle is controlled by one of the parties (the originator or the investor), then normally that entity shall consolidate the vehicle. However, IFRS 10 includes an exception to this rule for the parent entities considered as "investment entities". If the criteria of an investment entity are fulfilled, as described in Figure 28, then IFRS 10 prohibits from consolidating its subsidiaries/investments and requires these to be accounted for at fair value through profit or loss. This requirement does not apply to subsidiaries that are not themselves investment entities and whose main purpose is to provide services relating to the investor's investment activities.

An investment entity is an entity that holds investments for the sole purpose of capital appreciation, investment income (such as dividends, interest or rental income), or both. The most useful information for such an entity is provided by measuring all investments, including investments in subsidiaries, at fair value. Based on these characteristics, and looking at a securitisation transaction, the investor entity is more subject to be considered as an investment entity than the originator.

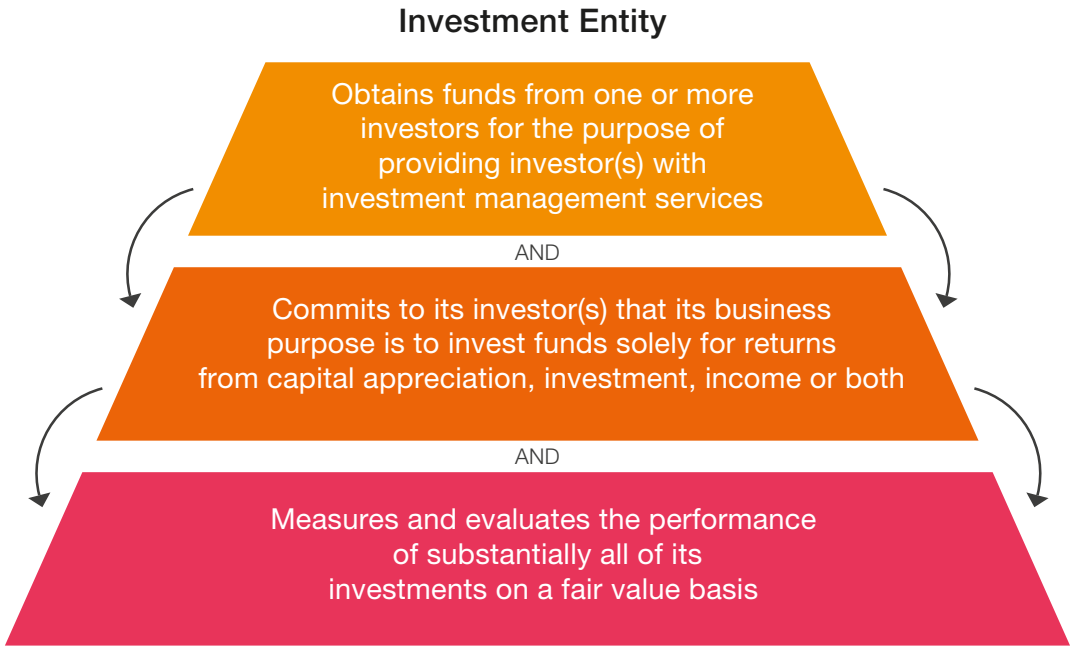
For an entity to qualify as an investment entity, the above definition must be met. The following typical characteristics of an investment entity must also be considered:

- holding more than one investment (this might refer to both equity (share investments) and debt (receivables) investments);
- having more than one investor;
- having investors that are not the entity's related parties; and
- having ownership interests in the form of equity or similar interests.

The above typical characteristics are indicative and supplement the definition to allow the use of judgement in assessing whether an entity qualifies as an investment entity. If management concludes that the entity is an investment entity in the absence of one or more of the typical characteristics above, it is required to explain in the financial statements how far the definition of an investment entity is met. It is highly unlikely that an entity will meet the definition of an investment entity if it shows none of the typical characteristics.

Therefore, an investor controlling a securitisation vehicle shall firstly assess if it is an investment entity before consolidating the respective subsidiaries/investments.

Figure 28: Definition of an investment entity



Consolidation – Disclosures

IFRS 12 contains disclosure requirements for consolidated financial statements, and intends to give relevant information to users to help them understand judgements and assumptions made, such as in regards to controlling another entity. However, even if a securitisation vehicle is not consolidated, IFRS 12 requires transparency about the risks that an entity is exposed to due to its involvement with structured entities, which was highlighted during the global financial crisis.

These main requirements include:

- disclosure of qualitative and quantitative information relating to involvement with these unconsolidated structured entities;
- disclosure of recognised assets and liabilities relating to involvement with the structured entities;
- disclosure of maximum exposure to loss, how this is determined and comparison to recognised assets and liabilities;
- disclosure of any financial support provided to the unconsolidated structured entity.

4.3 Other reporting requirements

BCL/ECB statistical reporting

The ECB has adopted several EU regulations concerning statistical reporting on the assets and liabilities of financial vehicle corporations ("FVC") engaging in securitisation transactions in order to provide the ECB with adequate statistics on the financial activities of the FVC subsector. Subsequently, the BCL has developed a data collection system for securitisation vehicles, which is defined in the BCL Circular 2014/236.

These regulations are directly applicable to Luxembourg securitisation vehicles subject to the Luxembourg Securitisation Law, as well as to commercial companies outside the scope of the Luxembourg Securitisation Law but conducting securitisation transactions.

The circular defines a concerned securitisation vehicle as an undertaking whose principal activity meets both of the following criteria:

(a) it intends to carry out, or carries out, one or more securitisation transactions and its structure is intended to isolate the payment obligations of the undertaking from those of the originator, or the insurance or reinsurance undertaking; and,

(b) it issues, or intends to issue, financing instruments and/or legally or economically owns, or may own, assets underlying the issue of financing instruments that are offered for sale to the public or sold on the basis of private placements.

In this context, three types of securitisation are identified for statistical purposes:

a) Traditional securitisation, referring to a securitisation involving the economic transfer of the exposures being securitised to a FVC which issues securities. This is accomplished by the transfer of ownership of the securitised exposures from the originator or through sub-participation. The securities issued do not represent payment obligations of the originator.

b) Synthetic securitisation, referring to a securitisation where the tranching is achieved by the use of credit derivatives or guarantees, and the pool of exposures is not removed from the balance sheet of the originator.

c) Other, referring to FVC that do not fall in the first two categories.

Therefore, each vehicle falling under the definition must comply with the following BCL reporting requirements.

In order to receive an identification code from the BCL, each concerned Luxembourg securitisation vehicle shall spontaneously inform the BCL of its existence within one week after its incorporation date. A registration form in Excel format requesting legal information about the securitisation vehicle, the nature of securitisation, ISIN codes of securities issued and information about the reporter (i.e. the entity submitting the data) is available on the BCL website.

Afterwards, the securitisation vehicles must provide the BCL regularly with information about their assets and liabilities and the transactions made. This information must be filed with the BCL within 28 working days in the form of the following three reports:

- Quarterly: S 2.14: Quarterly statistical balance sheet of securitisation vehicles;
- Quarterly: S 2.15: Transactions and write-offs/write-downs on securitised loans of securitisation vehicles;
- Monthly: TPTTBS "Security by security reporting of securitisation vehicles".

The BCL establishes and publishes on its website a calendar of remittance dates on which the monthly and quarterly statistical reports must be submitted to the BCL.

A certain amount of information must be provided about the securitised assets, including a breakdown of the country and economic sector of the counterparts, the currency and maturity as well as nominal values. Also, information about the issued securities needs to be reported.

Therefore, the reporting entity must ensure that all the data is made available in time in order to comply with the BCL requirements.

The BCL has exempted securitisation vehicles from the reporting requirement, given that the securitisation vehicles contributing to the quarterly aggregated assets/liabilities account for at least 95% of the aggregated assets of all Luxembourg securitisation vehicles. Currently, and unchanged since 2014, this threshold amounts to EUR 70 million (on a combined, company level).

In addition, all securitisation vehicles concerned, even those exempted from regular reporting, have to provide their annual accounts to the BCL if they are not public, e.g. published in the Luxembourg Trade and Companies' Register within the legal deadline of seven months after closure. The BCL also accepts draft balance sheets, but the signed financial statements must be provided as soon as they are available.

Since July 2016, the ECB and the BCL have been monitoring the compliance of reporting obligations more stringently. All infringements to the minimum requirements are recorded into a database. Sanctions may be imposed in case of failure to comply.

EU Securitisation reporting

Since 1 January 2019, entities falling in the scope of the EU Securitisation Regulation need to do additional extensive and standardised reporting under the transparency requirements of this regulation. This is described in more detail in section 6.

For more detailed information see:
https://www.bcl.lu/en/Regulatory-reporting/Vehicules_de_titrisation/index.html

5 Taxation aspects

The Luxembourg Securitisation Law has been successful in achieving almost complete tax neutrality. The following scheme shows the different types of taxes applicable to the two types of securitisation vehicles, securitisation companies (corporate or partnerships) and securitisation funds (an overview is given in Figure 29).

5.1 Tax specificities of securitisation companies

Securitisation corporate entities

Securitisation vehicles organised as corporate entities (i.e. SA, SARL, SCA, SAS and SCoop SA) are, as a rule, fully liable to corporate income tax ("CIT") and municipal business tax ("MBT") at an aggregate tax rate of 24.94% (tax rate applicable for 2023 for entities based in Luxembourg City, taking into account the solidarity surcharge of 7% on the corporate income tax rate of 17% and including the 6.75% municipal business tax rate).

Securitisation corporate entities are in principle taxed on their net accounting profits (i.e. gross accounting profits minus expenses). Exception to this principle can happen when the securitisation corporate entity invests in entities that should be regarded as transparent for Luxembourg tax purposes. According to the Luxembourg Securitisation Law, a securitisation company's commitments (normally to be materialised by a decision of the Board taken before year-end) to remunerate investors for issued bonds or shares and other creditors qualify as interest on debt even if paid as return on equity. Accordingly, they shall be considered as operating expenses for CIT and MBT purposes, so the tax liability should be rather limited unless such commitments can be regarded as borrowing costs not fully tax deductible as a consequence of the interest limitation rules (see Section 4.5.1.1.). However, it may be vital to secure the tax treaty benefits depending on the nature of the assets. In that respect, conditions to be met to get tax treaty access should be analysed from the source country perspective on a case-by-case basis.

The shareholders of the securitisation corporate entities are treated like bondholders. Dividend distributions made by a securitisation company are thus exempt from withholding tax. Interest payments are also exempt from withholding tax.

In addition, all securitisation vehicles organised as corporate entities, though excluded from the general net worth tax rates, fall within the scope of the minimum NWT. Depending on the structure of their annual accounts, either the annual fixed minimum NWT (EUR 4,815) or the annual progressive minimum NWT between EUR 535 and EUR 32,100 should apply. Conversely, securitisation vehicles organised as partnerships are not liable to NWT.

The annual fixed minimum NWT applies to companies with total gross assets above EUR 350,000 whose sum of fixed financial assets, transferable securities and cash at bank (as presented in their annual accounts presented in the standard Luxembourg form) exceed 90% of their total gross assets. In any other case, the annual progressive minimum NWT should apply.

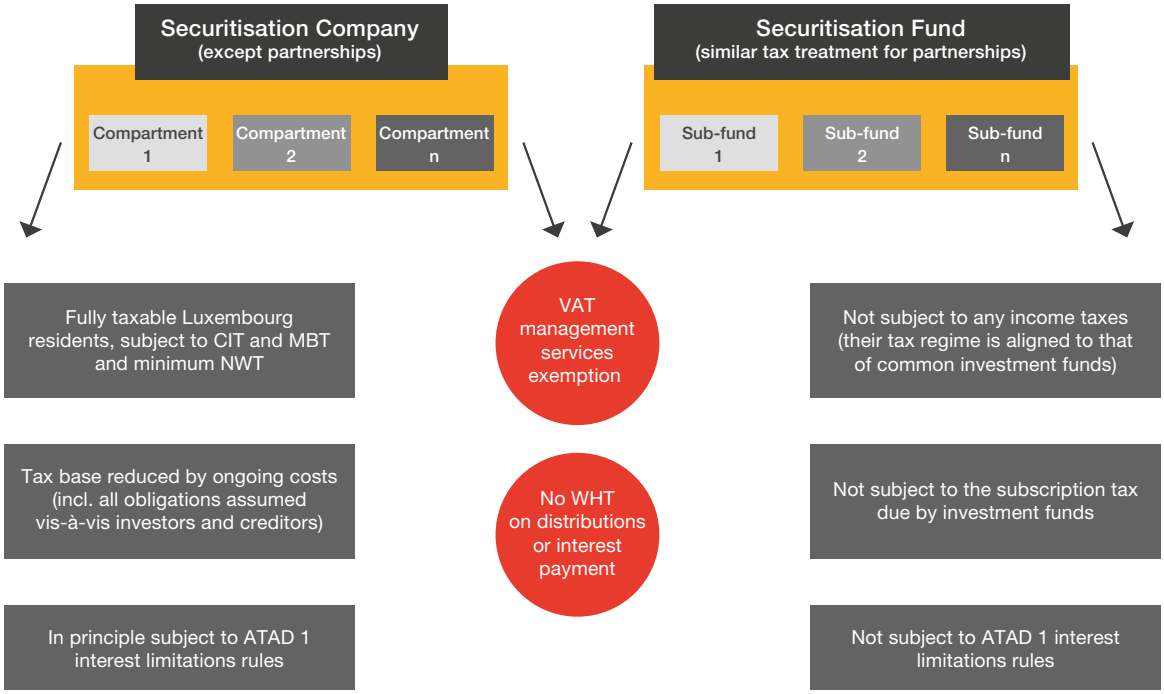
Securitisation partnerships

Securitisation vehicles organised as partnerships (i.e. SCS, SCSp or SNC) are, as a rule, not liable to CIT unless they qualify as a reverse hybrid entity. They should not be subject to MBT either if they are not conducting a commercial activity or are not deemed to conduct a commercial activity in Luxembourg. As the new Luxembourg Securitisation Law now allows an active management of a portfolio of debt instruments, a securitisation vehicle set up as a SNC, SCS or SCSp could be regarded in certain circumstances as carrying out a commercial activity. Moreover, a SNC should be deemed to conduct a commercial activity in Luxembourg if it is held by Luxembourg capital companies representing at least 50% of the interest while a SCS and SCSp should be deemed to conduct a commercial activity in Luxembourg if the Luxembourg General Partner holds an interest of at least 5% in the SCS or SCSp.

Fiduciary structures

In case of a fiduciary structure, assets held by the company acting as the fiduciary for the account of the fiduciant are regarded as held by the fiduciant for Luxembourg CIT, MBT and NWT (net wealth tax) purposes by application of § 11 of the Steueranpassungsgesetz of 16 October 1934. As a consequence, only the fiduciant will be taxed on the income, gains and wealth derived from the assets when resident in Luxembourg. In the presence of a non-Luxembourg resident fiduciant, such fiduciant will be taxable in Luxembourg only on Luxembourg sourced income unless it holds these assets through a Luxembourg permanent establishment.

Figure 29: Tax types applicable to the two securitisation forms



5.2 Transfer pricing aspects

A general transfer pricing regime is included in the Luxembourg tax code applying to all transactions between associated companies. This is per se also applicable to securitisation companies yet normally not to securitisation funds or partnerships. The legislation restates the arm's length principle, which becomes more aligned with the OECD[1] Model Tax Convention. The provisions provide for both upward and downward profit adjustments where transfer prices do not reflect the arm's length principle. In addition, the legislation clarifies that the current disclosure and documentation requirements for taxpayers to support their tax-return positions also apply to transactions between associated enterprises.

Nevertheless, and on the basis that the securitisation company is normally not involved in intra-group financing activities (i.e. it does not hold loan receivables from related parties), the transfer pricing rules should not have a significant impact on the securitisation companies and related tax treatment. However, it is recommended to undertake detailed analysis to verify that approach, including the analysis from the source country perspective, on a case-by-case basis.

[1] Organisation for Economic Co-operation and Development

5.3 Access to Double Tax Treaties

Since securitisation vehicles organised as corporate entities (i.e. excluding partnerships and funds) are fully taxable resident entities, they are expected to benefit from Luxembourg's tax treaty network and from the EU Parent-Subsidiary Directive. At present, Luxembourg has concluded the following 86 treaties and 12 others are under negotiation or still subject to ratification (see Figure 30).

Figure 30: Luxembourg Double Tax Treaty (DTT) network

Europe		Americas	Asia and Oceania		Africa
Albania*	Lithuania	Argentina	Armenia	Saudi Arabia	Botswana
Andorra	Macedonia	Barbados	Azerbaijan	Singapore	Cap Verde*
Austria	Malta	Brazil	Bahrain	South Korea	Egypt*
Belgium	Isle of Man	Canada	Brunei	Sri Lanka	Ethiopia*
Bulgaria	Moldova	Chile*	China	Thailand	Ghana
Croatia	Monaco	Mexico	Georgia	Taiwan	Mali*
Cyprus	Netherlands	Panama	Hong Kong	Tajikistan	Mauritius
Czech Republic	Norway	Trinidad and Tobago	India	UAE	Morocco
Denmark	Poland	United States	Indonesia	Uzbekistan	Rwanda
Estonia	Portugal	Uruguay	Israel	Vietnam	Senegal
Finland	Romania		Japan		Seychelles
France	Russia		Kazakhstan		South Africa
Germany	San Marino		Kyrgyzstan*		Tunisia
Greece	Serbia		Kuwait		
Guernsey	Slovakia		Laos		
Hungary	Slovenia		Malaysia		
Ireland	Spain		New Zealand*		
Iceland	Sweden		Oman*		
Italy	Switzerland		Pakistan*		
Jersey	Turkey		Qatar		
Kosovo	United Kingdom				
Latvia	Ukraine				
Liechtenstein					

- 88 DTTs enforced
- 10under negotiation or subject to ratification (*)

5.4 Tax specificities of securitisation funds

Since securitisation funds are treated in the same way as investment funds in Luxembourg, they are exempt from CIT, MBT and NWT. Securitisation funds furthermore benefit from a subscription tax ("taxe d'abonnement") exemption.

The unit holders of the securitisation fund are treated like bondholders. Dividend distributions and payments on fund units are thus exempt from withholding tax.

Lastly, from the investors' tax perspective, the securitisation funds are likely to be treated as tax transparent vehicles (though it would need to be verified with the relevant analysis on a case-by-case basis).

5.5 FATCA/CRS

FATCA

The Foreign Account Tax Compliance Act ("FATCA") rules have been incorporated in the US Internal Revenue Code and in the Final Regulations. The purpose of these provisions is to fight tax evasion by US persons holding accounts or investments abroad.

The regulations impose documentation due diligence, an identification of "US accounts" and a reporting and withholding obligation on Foreign Financial Institutions ("FFIs") that enter into an agreement with the Internal Revenue Service ("IRS"). FFIs that do not enter into such agreements would be subject to a 30% withholding tax on certain US source income (notably interests and dividends) and possibly on some non-US source income in the future (notion of pass-thru payment still being reserved for future guidance). In order to help Luxembourg Financial Institutions to comply with FATCA, Luxembourg signed an Intergovernmental Agreement ("IGA") with the US. According to the IGA, Financial Institutions in Luxembourg should report information about US accounts to the Luxembourg tax authorities, who will then transfer this data to the IRS.

Based on the Circular ECHA n°2 issued by the Luxembourg tax authorities, an authorised securitisation vehicle should qualify as FFI (i.e. Investment Entity) for FATCA purposes. In this case, we recommend conducting a FATCA analysis to assess whether a Non-Reporting FI status might be applicable.

With respect to a securitisation vehicle that is not authorised by the CSSF, it would need to be analysed on a case-by-case basis whether the securitisation vehicle might be considered as an Investment Entity or whether it might qualify as NonFinancial Foreign Entity (NFFE). Depending on the result of the analysis, different obligations will arise.

CRS

In 2014, the OECD released the full version of the Standard for Automatic Exchange of Financial Information in tax matters (Common Reporting Standard, "CRS"). Like FATCA, the CRS requires Financial Institutions around the globe to play a central role in providing tax authorities with greater access and insight into taxpayers' financial account data, including the income earned on these accounts.

In short, the CRS is intended to be a standardised, cost effective model for the bilateral and automatic exchange of tax information.

The standard provides for annual automatic inter-governmental exchange of financial account information, including balances, interest, dividends, and sales proceeds from financial assets, as reported to tax authorities by Financial Institutions and covering accounts held by individuals and entities, including trusts and foundations. It sets out the financial account information to be exchanged, the Financial Institutions that have to report, the different types of accounts and taxpayers to be covered, as well as common due-diligence procedures to be followed by Financial Institutions.

Depending on its activities, nature of assets, the number and volatility of its investors as well as its regulation, a securitisation vehicle might be considered as a Financial Institution for CRS purposes as well. In order to assess the potential effects and obligations derived from the CRS status of the vehicle, a thorough analysis will definitely be required.

Please note that if the securitisation vehicle qualifies as a Luxembourg Reporting Financial Institution for FATCA and/or CRS purposes, a governance around those regulations should be put in place and must include written policies and procedures, control over delegated functions and IT systems proportional to the size of the organisation.

In addition, individual investors reported should also be notified regarding the content of the report so that they could exercise their rights of access and rectification of data.

5.6 Value-added Tax (VAT)

5.6.1 VAT status of Luxembourg securitisation vehicles

Securitisation vehicles qualify as VAT taxable persons in Luxembourg. The VAT status of securitisation vehicles is indirectly due to the Court of Justice of the European Union's ("CJEU") case Banque Bruxelles Lambert ("BBL") that has been implemented in Luxembourg by the VAT Authorities through the Circular 723. Although the BBL case dealt with the VAT status of SICAVs, the VAT Authorities extended the reasoning of this case to all vehicles listed in Article 44.1.d) of the Luxembourg VAT Law (notably the securitisation vehicles).

Due to their VAT taxable person status, securitisation vehicles are required to register for VAT in Luxembourg and to file VAT returns if:

- they perform activities allowing input VAT recovery (e.g. portfolio of interest bearing loans directly held with non-EU counterparts); or
- in absence of activities allowing input VAT recovery, they receive taxable services from non-Luxembourg suppliers on which they are liable to self-account for Luxembourg VAT under the reverse-charge rule (or in the unlikely event they acquire goods transported to Luxembourg from another EU Member State and those acquisitions exceed EUR 10,000 in a calendar year).

VAT on costs incurred by a securitisation vehicle that are directly linked to activities allowing input VAT recovery is deductible, whereas VAT on costs directly linked to activities not allowing input VAT recovery is not deductible. The input VAT recoverable on overhead expenses incurred by a securitisation vehicle should be determined on a case-by-case basis, based on the activities or the investments performed by the securitisation vehicle.

Securitisation vehicles without input VAT recovery right and liable to self-assess Luxembourg VAT under the reverse charge mechanism are only required to file a single short-form VAT return per calendar year to declare their expenses from abroad. However, the VAT authorities can request the filing of periodic and annual recapitulative VAT returns if certain thresholds of reverse chargeable services received by the securitisation vehicle (or goods acquired and transported from another EU Member State to Luxembourg) are exceeded.

It is also important to note that a securitisation vehicle that, at its own risk, purchases defaulted debts at a price below their face value does not perform activities in the scope of VAT when the difference between the face value of those debts and their purchase price reflects the actual economic value of the debts at the time of their assignment. A careful analysis of the activities performed by each securitisation vehicle should therefore be made to determine the VAT status of such entities and their reporting requirements correctly.

5.6.2 VAT exemption of management services rendered to securitisation vehicles

Article 135 1(g) of the VAT Directive (2006/112/EC) provides that the management of special investment funds as defined by Member States is exempt from VAT. Article 44.1.d) of the Luxembourg VAT Law lists the eligible funds/vehicles. As this list includes securitisation vehicles, management services rendered to Luxembourg securitisation vehicles are consequently VAT exempt.This is a competitive advantage of Luxembourg to some other jurisdictions.

The concept of "management services" is, however, not clearly defined, though the management of investment funds has been clarified. In addition to managing the portfolio, some administrative services can benefit from the VAT exemption. In April 2010, the Luxembourg VAT authorities issued Circular letter 723bis ("Circular n° 723bis") aiming to clarify the VAT exemption of outsourced fund management services. Circular n° 723bis also recalls some principles provided by the CJEU in the Abbey National case. In order for outsourced services to be VAT-exempt, they must constitute a distinct whole and be specific and essential to the management of special investment funds. In this circular, the VAT authorities add that if one single type of service is outsourced, the VAT exemption would, in principle, not apply. Investment management services are also regarded as "management services" benefiting from the VAT exemption according to the CJEU in the Gesellschaft für Börsenkommunikation mbH case.

So far, Luxembourg has widely applied the exemption. Still every service rendered to the securitisation vehicle should be carefully analysed. The documentation, services agreement, and invoices should be reviewed to determine if the conditions for a VAT exemption might apply. This is particularly relevant for services such as origination, asset servicing, asset management, calculation and report, valuation, etc. If properly structured, a Luxembourg securitisation vehicle is able to significantly reduce the amount of irrecoverable VAT and operational costs.

5.7 BEPS initiative/Anti-Tax Avoidance Directives

The international tax system has changed due to coordinated actions taken by governments and unilateral measures designed by individual countries, both intended to tackle concerns over base erosion and profit shifting ("BEPS") and perceived international tax avoidance techniques of high-profile multinationals. The recommendations of the BEPS project led by the OECD and published in October 2015 are at the root of much of the coordinated activity, although the timing and methods of implementation vary.

Furthermore, EU followed the above trend with the Anti-Tax Avoidance package, i.e. Anti-Tax Avoidance Directive 2016/1164 ("ATAD 1") of 12 July 2016 and the Anti-Tax Avoidance Directive 2017/952 of 29 May 2017 ("ATAD 2") and the draft directive 2021/0434 (CNS) ("ATAD 3") – together known as "ATAD" – as well as with the Directive of 25 November 2022 introducing a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the European Union (so called "Pilar 2 Directive")

5.7.1 Anti-Tax Avoidance Directive (ATAD 1, 2, 3)

ATAD basically sets out minimum standards that the EU Member States need to adhere to in several areas covered by the OECD works on the BEPS initiative including, inter alia, (i) rules on the deductibility of interest limitations addressed in ATAD 1 and (ii) rules on how to tackle hybrid mismatches (between EU Member States as well as between EU Members States and non EU countries) addressed in ATAD 1 & 2. Whereas the ATAD stipulates minimum standards to be applied to all taxpayers subject to corporate tax in one or more EU Member States, it does not prohibit other anti-avoidance rules designed to give greater protection to the corporate tax base.

On 18 December 2018, the Luxembourg Parliament voted the ATAD 1 Law to transpose the EU Anti-Tax Avoidance Directive 2016/1164 into Luxembourg domestic tax law. This law introduced (i) interest limitation rules and (ii) anti-hybrid mismatch rules between EU Member States as from 1 January 2019.

As to the ATAD 2, it was transposed into Luxembourg tax Law on 19 December 2019 and the purpose of the ATAD 2 Law aimed to introduce anti-hybrid mismatch rules with third countries as from 1 January 2020.

Moreover, on 22 December 2021, the European Commission released a draft ATAD 3 that aims to prevent the misuse of shell entities for tax purposes that could limit the tax benefit claimed by securitisation companies as from 2024. This draft Directive still needs to be approved by the Council of the European Union and may likely be altered before approval. It is still to be seen if the application date will remain 2024.

5.7.1.1 Interest limitation rules (ATAD 1)

The aim of the interest limitation rules is to limit the tax deduction of interest expense that exceeds the amount of interest income or income economically equivalent to interest income (i.e. exceeding borrowing costs) to 30% of the EBITDA of the taxpayer. Tax exempt revenues like dividend income and capital gains derived from qualifying participation shall be excluded when computing the EBITDA of the taxpayer.

As the interest limitation rules apply only to Luxembourg entities subject to corporate tax and to foreign entities having a Luxembourg permanent establishment, securitisation funds set up in the form of FCPs that are not subject to CIT are not subject to these new interest limitation rules.

However, securitisation vehicles organised as corporate entities (e.g. SA, SARL, SCA, Scoop SA and SAS) which are fully subject to CIT are in scope of the new interest limitation rules, unless an exemption applies. Conversely, securitisation vehicles organised as partnerships (i.e. SCS, SCSp or SNC) which are not liable to CIT should not be subject to the interest limitation rules unless they constitute a permanent establishment in Luxembourg for their non-resident partners. In theory, this could happen only if the partnership conducts its activity through a fixed place of business in Luxembourg. Therefore, it is important that securitisation partnerships do not constitute a fixed place of business. Moreover, limited partners of the securitisation partnership should not be Luxembourg corporate entities as by transparency these latter would be regarded as holding the assets of the partnership.

Available exemptions

The ATAD 1 Law provides for multiple exemptions as follows:

De minimis rules of EUR 3 million per year

The exceeding borrowing costs incurred during the financial year are deductible without any limitation up to EUR 3 million. This amount needs to be calculated at the company level and not only at the compartment level.

Grandfathering for debt instruments concluded before 17 June 2016

When determining the amount of exceeding borrowings costs, a taxpayer may exclude borrowings costs arising from borrowings concluded before 17 June 2016. The exclusion shall not extend to any subsequent modification of the debt instrument or agreement, which means that the amount of deductible borrowing costs should be computed as if no amendments took place. Therefore, interest expenses on debt instruments issued before 17 June 2016 (subject to review of their potential amendments and their effects on the initial debt) should not be subject to these interest limitations rules. Interestingly, in their administrative circular of 8 January 2021, the Luxembourg tax authorities took the position that any drawdown made under a credit facility concluded before 17 June 2016 should also be grandfathered even when they have been made after that date so that one could conclude that any payment made under notes issued under terms and conditions agreed prior to 17 June 2016 should be grandfathered and therefore should not be subject to the interest limitations rules.

Stand-alone entity

The ATAD 1 Law provides that a stand-alone entity is exempted from the interest limitation rules. Based on common understanding, securitisation companies whose shares are held by a trust, foundation, or Stichting are usually considered as "orphan". However, the ATAD 1 Law defines a stand-alone entity as a taxpayer that is not part of a consolidated group for financial accounting purposes and has no associated enterprise (to be understood as an entity which includes trusts, foundations, and Stichtings holding directly or indirectly more than 25% of the share capital, voting rights or profits entitlements of the taxpayer (according to the administrative circular of 8 January 2021, the 25% threshold must be analysed from an economic perspective) or non-Luxembourg permanent establishment.

As a result of the provisions of the ATAD 1 Law, a securitisation company fully held by a single trust, foundation, or Stichting that can be regarded as the beneficial / economic owner should not be regarded as a stand-alone entity and should thus be in scope of the interest limitation rules.

EU securitisation vehicles

Securitisation companies in the meaning of Article 2 point 2 of the Regulation (EU) No 2017/2402 ("EU Securitisation Regulation") are out of scope of the interest deduction limitation rules. In substance, this will suppose the existence of securitisation of credit risk and the subordination through tranching.

However, in the May 2020 infringements package, the European Commission requested Luxembourg to amend the ATAD 1 Law considering that this exemption goes beyond the allowed exemptions. As a consequence of this, on 9 March 2022, the Luxembourg government released a draft bill n°7974 to remove this exemption for tax years starting on or after 1 January 2023. As this draft bill has not been voted in the course of 2022, there is a question mark if such law will still apply for tax years starting on or after 1 January 2023 when it will be voted in the course of 2023.

Alternative Investment Funds

Alternative Investment Funds ("AIF") in the meaning of the AIFM Directive 2011/61/EU ("AIFMD") are out of scope. Therefore, a securitisation company qualifying as an AIF in the meaning of the AIFMD, should not be subject to the interest limitation rules.

Equity ratio exemption

When the Luxembourg securitisation company meets the conditions to be consolidated for accounting purposes, the indebtedness of the consolidated group may be considered

for the purpose of assessing whether the interest limitations rules apply. In other words, if the debt to equity ratio of the securitisation company is not lower than 2% compared to the debt to equity ratio of the consolidated group, in such a case the interest limitation rules do not apply to the securitisation company. Such exemption must be claimed every year in the tax return of the securitisation company.

Importance of the definition of exceeding borrowing costs

When the securitisation company cannot rely on any of the above exemptions, it is important to compute the amount of exceeding borrowing costs. Borrowing costs are defined in the ATAD 1 Law as interest expenses on all forms of debt and other costs economically equivalent. The rule applies to any financing, irrespective of whether provided by related parties or third parties. The ATAD 1 Law provides the following non-exhaustive list of borrowing costs:

- Remuneration due under profit participating loans;
- Imputed interest on instruments such as convertible bonds and zero coupon bonds;
- Amounts disbursed under alternative financing arrangements, such as Islamic finance;
- Finance cost element of finance lease payments;
- Capitalised interest included in the balance sheet value of a related asset, or the amortisation of capitalised interest;
- Amounts measured by reference to a financial return under transfer pricing rules where applicable;
- Notional interest amounts under derivative instruments or hedging arrangements related to an entity's borrowings;
- Certain foreign exchange gains and losses on borrowings and instruments connected with the raising of finance;
- Guarantee fees for financing arrangements;
- Arrangement fees and similar costs related to the borrowing of funds.

In practice, securitisation companies not having significantly more interest expenses than interest income should thus not be substantially impacted by the interest limitation rules.

One of the issues for some securitisation companies comes from the fact that the ATAD 1 Law does not provide a clear definition or guidance for interpretation of what constitutes interest revenue and other economically equivalent taxable revenue.

However, in their administrative circular of 8 January 2021, the Luxembourg tax authorities consider that regarding the definition of interest revenue and other revenue economically equivalent to interest revenue, a symmetrical approach should be followed, i.e. what is regarded from a Luxembourg tax perspective as interest expenses on all forms of debt payable or other expenses economically equivalent to interest expenses according to the law shall be regarded as interest revenue and revenue economically equivalent to interest revenue when accrued on all forms of debt receivables (and vice versa).

Interestingly, the Luxembourg tax authorities consider that foreign exchange gains on debt principal should not be regarded as interest revenue (while foreign exchange gains on accrued interest should be regarded as interest income) and impairments booked on debt instruments should not be regarded as borrowing costs. Conversely, one could conclude that a reversal of an impairment should not be regarded as interest income.

Unfortunately, the administrative circular does not expressly address the tax treatment applicable to gains made from performing and non-performing loans bought at a discount which creates some uncertainties for the taxpayer that is therefore required to analyse each transaction on a case by case basis to determine if the gains could be regarded as economically equivalent to interest income. Same uncertainty remains for the tax treatment applicable to distributions / commitments made by securitisation vehicles that have the particularity to be in principle tax deductible.

Practical implications

We have analysed the most common securitisation transactions with regards to the potential implications the ATAD 1 Law might have on the transactions. The following is our view based on the text of the ATAD 1 Law and OECD BEPS Action 4 which inspired the ATAD 1 Law.

Transactions paying (or accruing) regular interest income in the hands of the securitisation vehicle should not be adversely impacted by ATAD 1 Law. Indeed payments to noteholders would thus remain deductible up to that amount. Typical interest receiving transactions are mainly securitisations of bonds, performing loans, trade or leasing receivables. Also discounts received on those assets are usually accounted for as interest to which they are economically linked. For non-performing loans, the situation is more complex and the tax treatment of gains from repayments above acquisition costs of the non-performing loans as interest revenue or economically equivalent revenue remains controversially discussed in the market.

We also see repackages of investment funds refinanced by notes issued. If these funds are paying dividends which are distributed as variable interest under the notes, we expect a negative impact of the interest limitation rule due to the asymmetry of the type of cash flows. On the other hand, if the repayable amount of the notes tracks the fair value of the underlying funds, the realisation of the asset will result in a capital gain (loss) which will be paid out to the note holder in form of an increased (decreased) repayment amount, i.e. a capital loss (gain) for the issuer. Based on the principle of symmetry, one could argue that neither the capital gain or loss from assets nor from notes issued would be treated as interest revenue or borrowing costs, and therefore the interest limitation rule should not apply. In this regard, the Luxembourg tax authorities consider in their administrative circular that a premium paid upon repayment of a debt instrument can be regarded as borrowing costs when such premium can be regarded as imputed interest on debt instruments such as convertible bonds and zero coupon bonds.

An important part of the Luxembourg securitisation market is made of structured products, i.e. the issuance of performance linked certificates. Typically, the proceeds of the certificates issued are invested into debt instruments, like a bond or a deposit. The interest from the debt instrument is then swapped into the performance promised to the certificate holders. For structures with a debt instrument as underlying, the amount received is booked as interest revenue and as the swap or derivative instrument payments are hedging this income, any payment made and received under the swap of the derivative instrument could be regarded as respectively borrowing costs and interest revenue. Therefore, as in this scenario only interest revenue could be considered as received by the securitisation vehicle, all borrowing costs accruing under the notes issued should remain fully tax deductible. Another approach could consist of analysing separately each payment made under the two legs of the swap or derivative instrument but this is not the practice of the Luxembourg tax authorities. For other forms of underlyings, this may be less obvious and we recommend performing an in-depth analysis as tax implications may vary on a case-by-case basis.

5.7.1.2 Anti-hybrid mismatch rules (ATAD 2)

The ATAD 1 Law and ATAD 2 Law also introduced rules to tackle hybrid mismatches that are defined as situations resulting in either a deduction without inclusion or a double deduction for tax purposes. Such situations can happen amongst others in the presence of payment made under a hybrid instrument or payment made to or by a hybrid entity. Moreover, such hybrid mismatch must notably result from either a structured arrangement or an arrangement between associated enterprises.

There can be a hybrid mismatch when an investor subscribes to an instrument (e.g. note, certificate, warrant) through a hybrid entity which is regarded as tax transparent in its jurisdiction of residence and as a taxable entity under the laws of the jurisdiction of the investor which leads to a deduction at the level of the securitisation company and an absence of inclusion at the level of the investor.

However, unless the case of a structured arrangement as defined in the ATAD 2 Law, such anti-hybrid mismatch rules only apply between associated enterprises which supposes that the investor holds directly or indirectly a participation of more than 25% in the securitisation company in terms of voting rights, capital ownership, or entitlement to profits. Such percentage is set at 50% when the investor holds the participation in a securitisation company through a hybrid entity. Investors acting together shall be aggregated to determine these 25% or 50% thresholds.

As in practice investors are often not meeting the conditions to be regarded as associated enterprises particularly when they are not shareholders but only creditors, such anti-hybrid mismatch rules provided by the ATAD 1 Law and ATAD 2 Law should in practice have limited implications for the majority of the securitisation companies. Nevertheless, it is recommended to undertake detailed analysis to verify the absence of implications

of the ATAD 1 Law and ATAD 2 Law notably when investors are also shareholders of the securitisation company/partnership or shareholders of the securitisation fund.

5.7.1.3 Anti-Shell entities rules (ATAD 3)

On 22 December 2021, the European Commission released a draft ATAD 3 that aims to prevent the misuse of EU shell entities for tax purposes that could limit the tax benefit claimed by Luxembourg securitisation companies as from 2024.

A shell entity is defined as an entity domiciled in the EU that does not meet the minimum cumulative substance indicators that are (i) premises available for the exclusive use of the undertaking, (ii) a bank account open and active in the EU and (iii) at least one qualified director who is tax resident in the same Member State. Such shell entities will no longer be able to get a tax certificate unless it can demonstrate that it has been set up for genuine economic reasons (i.e. non-tax reasons) or there is no tax benefit for its beneficial owner(s).

Interestingly, the draft ATAD 3 provides for an exemption for notably companies which have transferable security (equity or debt instruments) admitted to trading or listed on a regulated market or multilateral trading facility as defined under Directive 2014/65/EU as well as for regulated financial undertakings that includes securitisation special purpose entity as defined in the EU Securitisation Regulation.

Final provisions of ATAD 3 have not been agreed yet by the ECOFIN which requires unanimity between Member States and therefore it is unlikely that ATAD 3 will be applicable as from 2024 but rather as from 2025.

5.7.2 Pillar 2 Directive

On 15 December 2022, the EU Member States adopted the Directive 9778/22 introducing a global minimum level of taxation of 15% for multinational enterprise groups and large-scale domestic groups in the European Union (the “Pillar 2 Directive”) as from fiscal years starting on or after 31 December 2023.

The Pillar 2 Directive applies only to groups which have annual gross revenue in the consolidated financial statements exceeding EUR 750m. Consolidation should generally be on a line-by-line basis (with exceptions for certain joint venture entities). On 2 February 2023, the OECD published their administrative guidance and confirmed that the Pillar 2 rules do not apply to entities meeting the EUR 750m threshold when the Authorised Financial Accounting Standard explicitly permits the non-consolidation (e.g. IFRS 10 on investments entities, Fund product laws like SIF, RAIF and SICAR Laws, EU Accounting Directive 2013/34/EU). Therefore, vehicles which are not part of a consolidated group because an exemption is available should in principle not be subject to the Pillar 2 Directive and their revenue shall not be considered to assess the EUR 750m consolidated revenue threshold.

When a securitisation vehicle is part of a consolidated group, it can still benefit from an exemption if it qualifies as an investment fund meeting some criteria which is rare in practice.

When the effective tax rate applicable to all the Luxembourg constituent entities (including the securitisation vehicle) of the consolidated group is below 15% (which could happen for a Luxembourg securitisation company funded by equity claiming a tax deduction for commitments made to shareholders), top-up tax is expected to apply, unless the jurisdiction can qualify for one of the safe-harbour exclusions. Such top-up tax could possibly apply either in the jurisdiction of the Ultimate Parent Company, in Luxembourg or in another jurisdiction implementing the minimum taxation rules, including EU and non-EU jurisdictions.

5.7.3 Interest payment made to corporate entities located in non-cooperative jurisdictions

Since 1 March 2021, interest payment made by a securitisation company to corporate entities that are related parties and established in countries that are listed by the Council of the EU as being “non-cooperative” should no longer be tax deductible unless the Luxembourg securitisation company can prove that the arrangements giving rise to the expense satisfy the “valid commercial reasons that reflect economic reality” test.

In practice, this new tax provision should have a limited impact on Luxembourg securitisation vehicles as often the cumulative conditions are not all met.

5.7.4 Multilateral Instrument

In 2017, Luxembourg was one of the original 68 jurisdictions to sign the OECD-sponsored Multilateral Convention to implement Tax Treaty Related Measures to prevent base erosion and profits shifting – commonly referred to as the “Multilateral Instrument” or “MLI”.

The aim of the MLI is to supplement existing double tax treaties concluded by participating jurisdictions in order to include anti-tax treaty shopping provisions like the Principal Purpose Test. Under the Principle Purpose Test, a benefit under a double tax treaty shall not be granted in respect of an item of income or capital if it is reasonable to conclude that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provision of this double tax treaty.

On 14 February 2019, Luxembourg Parliament ratified the MLI which took effect on 1 January 2020. As a consequence, once the relevant treaty co-signatory has also ratified the MLI, any Luxembourg securitisation company claiming benefit from a double tax treaty will now have to pass the Principal Purpose Test to secure the benefit from reduced or nil withholding taxes at source.

As the vast majority of securitisation companies have been set up for genuine economic reasons, just a few should be impacted by the entry into force of the MLI.

5.7.5 Mandatory Disclosure Requirements/ DAC 6

On 25 May 2018, a new Council Directive 2018/822 was adopted which introduced a mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements implemented after 25 June 2018. Such Directive implements the recommendation made by the OECD in the BEPS Action 12 and requires in substance that EU tax intermediaries report cross-border arrangements that are potentially aggressive tax planning arrangements.

Such Directive has been transposed through the vote of the draft bill n°7465 on 21 March 2020 (“MDR Law” also known as DAC 6 Law). Such MDR Law may result in extra reporting obligations notably for sponsors, arrangers or tax advisors advising securitisation arrangements.

The MDR Law provides that only cross-border arrangements between associated enterprises that include some specific hallmarks are reportable. As a consequence, a case-by-case analysis shall be conducted to determine whether arrangements involving a securitisation vehicle are reportable under the MDR Law.

6

Regulatory aspects

6.1 EU Securitisation Regulation

In order to limit the risks and ensure the stability of the European economy drawing lessons from the 2008 financial crisis, the European Parliament adopted Regulation (EU) 2017/2402 of the European Parliament and of Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisations (the "Regulation").

The Regulation, which is applicable to European securitisation transactions whose securities (or other securitisation positions) are issued on or after 1 January 2019, is a key element of the European Commission's Capital Markets Union ("CMU")[1] and supports the development of the European securitisation market. The purpose of the Regulation is to promote securitisation as an important element of well-functioning financial markets, diversifying funding sources and allocating risk more widely. It allows for a broader distribution of financial-sector risk and can help free up originators' balance sheets to enable further lending to the real economy.

With the Regulation, the European Union aims to streamline the legislative framework on securitisation into a single harmonised securitisation regulatory framework. Consequently, the Regulation applies to several parties involved in a securitisation transaction, namely institutional investors (in principle no distribution to retail clients), originators, sponsors, original lenders, and securitisation special purpose entities ("SSPE" or the issuer).

The Regulation is divided into two parts. The first general part provides a definition of securitisation and the related concepts. It establishes, among others, due-diligence, risk retention, and transparency requirements for parties involved in any securitisation that falls within the definition of the Regulation. In its second part, the Regulation creates an additional specific framework for simple, transparent and standardised ("STS") securitisation.

In addition, the European Banking Authority ("EBA") and the European Securities and Markets Authority ("ESMA") as well as the European Insurance and Occupational Pensions Markets Authority ("EIOPA") have published so-called Level 2 Regulations, known as regulatory technical standards and implementing technical standards. They have also provided Level 3 Guidelines, known as guidelines and Q&A, in order to give further guidance and detail on several aspects of the Regulation. The Level 2 Regulations contain the implementation of some aspects of the Regulation. For example, they cover the requirements for third party verification, STS notification, the implementation of the transparency requirements, risk retention and homogeneity requirements for the securitised portfolio. The Level 3 Guidelines predominantly cover the uniform interpretation and application of the STS-requirements throughout Europe. Furthermore, a "Questions and Answers" document on the Regulation was published and is updated from time to time in order to assist market participants with the application of the new rules[2].

[1] Originally established by the Action Plan on Building a Capital Markets Union dated 20 September 2015 available on *https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52015DC0468*

[2] The latest updated Q&A dated 19 November 2021 is available on *https://www.esma.europa.eu/press-news/esma-news/esma-updates-its-questions-and-answers-securitisation-regulation-0*

On 10 June 2020, the so-called High Level Forum ("HLF") published a report with 17 interconnected recommendations[1] aimed at removing the main barriers for the CMU, including in relation with the Regulation. The recommendations include, among others:

- simplifying the process for significant risk transfer (SRT);
- adjusting the prudential treatment of securitisation for banks and insurers;
- supporting the development of synthetic securitisation;
- reconsidering the eligibility of securitisation for liquidity purposes;
- simplifying disclosure and due diligence for private securitisations.

In 2021, the Regulation was further amended with regards to the role securitisation has to play in recovery programs after the Covid-19 pandemic. The European Parliament adopted Regulation (EU) 2021/557 of the European Parliament and of the Council dated 31 March 2021 amending the Regulation and adopted Regulation (EU) 2021/558 of the European and of the Council of 31 March 2021 amending the Capital Requirements Regulation ("CRR") in order to aid recovery. In this context, the requirements for non-performing exposures ("NPE") securitisations and for on-balance-sheet synthetic securitisation have been amended.

The Regulation now includes the key definition of NPE securitisations, while the existing framework was built around the characteristics of performing loans. This includes adjustments to the risk retention requirements, the credit-granting rules and a proposal for amending the CRR concerning the risk weighting for NPEs. Furthermore, on-balance sheet synthetic securitisations can now qualify as STS transactions, while arbitrage securitisations remain ineligible for STS. This implies a preferential capital requirements treatment for such transactions.

6.1.1. General framework for all EU securitisations

Definition of securitisation in the meaning of the Regulation ("EU Securitisation")

Pursuant to Article 2.1 of the Regulation, the term "securitisation" is defined as "a transaction or scheme, whereby the credit risk associated with an exposure or a pool of exposures is tranched", having all of the following characteristics:

1. Payments are dependent upon the performance of the underlying exposure (or the pool of exposures).
2. The subordination of tranches determines the distribution of losses during the ongoing life of the transaction.
3. The transaction shall not constitute a specialised lending to finance or operate physical assets as defined in Article 147 (8) of Regulation (EU) No 575/2013 (CRR).

In addition, Article 8 of the Regulation prescribes that the securitised risk shall, as a rule, not be another securitisation, i.e. the Regulation prohibits in general re-securitisation. This can be seen as a consequence of the lessons learnt from the 2008 financial crisis. By way of derogation, this ban shall not apply to (i) any securitisation the securities of which were issued before 1 January 2019 and (ii) any securitisation to be used for legitimate purposes.

The "legitimate purposes" are left at the discretion of the relevant authority (i.e. in Luxembourg the CSSF). The relevant authority has to assess, among others, whether the re-securitisation takes place (i) to facilitate the winding-up of a credit institution, an investment firm or a financial institution, (ii) to ensure the viabilities of the latter and (iii) to protect the investors' interest.

The securitisation definition seems to be rather simple with only credit risk and tranching as key criteria. However, in practice, especially the notion of tranching gives room to interpretation. We have outlined the three main discussion points:

[1] Available on *https://finance.ec.europa.eu/publications/high-level-forum-capital-markets-union_en#description*

- *Does tranching only refer to different transferable securities issued or does it include other ways of subordination?*
  Even though the recitals and some Articles of the Regulation refer to "securities", the securitisation and tranching definitions themselves do not make such restriction. This implies that subordinated loans or other forms of distribution of credit losses would be seen as tranching.
- *Is the share capital of a securitisation vehicle (in addition to one single note issued) be seen as tranching?*
  Reference is made to "contractually" separate tranches, while it is legally defined that the share capital ranks lower than debt. Therefore, this alone would not trigger tranching. Since its modernisation, the Luxembourg Securitisation Law further prescribes a more detailed legal ranking of debt and equity positions which may then not meet the tranching definition of the Regulation. Nevertheless, each transaction should be analysed individually since for example a structuring within an entity's share capital (e.g. differently ranked share types or classes) would most likely be seen as tranching.
- *Is it tranching if all tranches are held by the same investor?*
  In our view, for the Regulation it is not relevant who the investor is. One needs to analyse from a transaction/vehicle point of view, not from an investor's angle. Therefore, having issued several tranches with different rankings with regards to credit risk would imply tranching in the meaning of the Regulation, regardless of the investor.

Furthermore, multi-compartment structures are not explicitly dealt with in the Regulation, i.e. it does not clarify if it shall be applied on an entity or compartment basis. In our opinion and what we understand to be best practice, each compartment should be treated separately being legally ring-fenced silos with clear segregation of assets and liabilities. This implies that any below mentioned obligation would have to be fulfilled for compartments falling in the scope of the Regulation, not for all compartments of the securitisation vehicle.

The Luxembourg Capital Markets Association has also issued to its members a position paper dated November 2021 on specific aspects of the Regulation[1].

Parties subject to the Regulation

An institutional investor within the meaning of the Regulation may be a European Union-based:

- insurance or a reinsurance undertaking;
- institution for occupational retirement provision;
- alternative investment fund manager ("AIFM");
- undertaking for the collective investment in transferable securities ("UCITS") if internally managed, or otherwise its management company;
- credit institution or investment firm.

Pursuant to Article 25 of the Regulation, the role of a sponsor within the meaning of the Regulation is limited to credit institutions (whether located in the European Union or not) and EU investment firms (the latters have to be supervised under Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment forms ("CRD")). On the other hand, any entity pursuing the respective activity can act as originator or original lender. The SSPE is not restricted in legal form or jurisdiction (except that SSPEs shall not be established in a third country fulfilling the conditions mentioned in Article 4 of the Regulation i.e. listed as a high-risk and non-cooperative jurisdiction by the Financial Action Task Force ("FATF")). The latter could be, for example, established as a limited partnership, a limited liability company, a trust, or a corporation. If STS compliance is intended, the SSPE, the sponsor or the initiator must be established within the European Union pursuant to Article 18 of the Regulation.

This also means that a non-EU or non-regulated originator could be caught by the Regulation. Similarly, a non-EU SSPE that meets the above mentioned credit risk and tranching criteria would trigger further obligations for an EU institutional investor and the SSPE itself. For example, US agency MBS are not per se out of scope of the Regulation but only if they do not meet the definition of a securitisation as per the Regulation (which, for example, is usually the case for the so-called pass-through securities).

[1] LuxCMA Task Force – Securitisation, EU Securitisation Regulation Position Paper, November 2021 avalaible on *https://www.luxcma.com/images/news/2021/20211129_PREVIEW_EU_Sec_Regulation_Reference_paper.pdf*

All these actors must meet one or more of the requirements prescribed by the Regulation. Those are, among others, relating to (i) due-diligence (for institutional investors), (ii) risk retention (for originators, sponsors, or original lender) and (iii) transparency (for originators, sponsors, and SSPEs).

Furthermore, the Regulation prescribes that loan origination must follow the same credit-granting process as the usual process of the originators, sponsors and original lenders.

The Regulation further foresees that any relevant data under the transparency requirements need to be collected by a so-called "securitisation repository" for public securitisations.

The UK implemented most of the Regulation's provisions into UK Law (through "Securitisation (Amendment) (EU Exit) Regulations 2019") but is itself no longer part of the European Union since 31 December 2020. For the Regulation this means that requirements linked to a geographic location in the EU (e.g. key parties involved in an STS transaction) would no longer be fulfilled by UK entities.

Not long after the end of the Brexit transition period and in order to face the Covid-19 crisis, the European Union approved a number of modifications to the Regulation. Inevitably, divergences came to light between the UK and EU regulatory frameworks rendering cross-border securitisation deals more complicated; securitisation fitting into one jurisdiction's standards may not automatically fit into the other jurisdiction's standards.

The details on the jurisdictional scope of the Regulation have been a point of discussion since its application. On 25 March 2021, the European Supervisory Authorities (EBA, EIOPA and ESMA, together the "ESAs") gave their opinion on this topic and proposed amendments to the Regulation[1]. The opinion addresses situations where one of the parties is non-EU and the implications for investment managers for their due diligence.

In addition, the Joint Committee of the ESAs published and subsequently updated Q&As in order to promote common, uniform and consistent supervisory approaches and practices to the day-to-day application of the Regulation[2].

The Joint Committee of the ESAs has since published its advice on the review of the securitisation prudential framework on 12 December 2022[3]. This advice includes targeted recommendations to support the securitisation market in a prudent manner and to promote the issuance of resilient securitisations qualifying for a more beneficial capital treatment, without jeopardising investor protection and financial stability.

Key requirements from the Regulation

(i) Due-diligence

Investor protection is a major purpose of the Regulation as securitisation operations may turn out to be risky and complex and should consequently be addressed by a strict due-diligence requirement.

Pursuant to Article 5 of the Regulation, prior to holding a securitisation position, institutional investors must verify certain elements of the transaction, e.g.:

- the existence of a well-defined credit-granting process of the originator (except if EU credit institutions or investment firms);
- the compliance of originator/sponsor/original lender with risk retention requirements;
- the regular provision of required information by originator/sponsor/SSPE.

Institutional investors also have to carry out a due-diligence assessment, which enables them to assess the risks characteristics and structural features. They must establish written procedures (initially and on an ongoing basis) and regularly perform stress tests in order to monitor the above-mentioned compliance and the performance of the securitisation position.

For due-diligence, no Level 2 Regulation was produced that could give further guidance. Yet, non-compliance could lead to significant sanctions. A strong focus of the due-diligence will be placed on the Loan Level Data templates (see (iii) below).

[1] ESAs publish Joint Opinion on jurisdictional scope under the Securitisation Regulation available on *https://www.esma.europa.eu/press-news/esma-news/esas-publish-joint-opinion-jurisdictional-scope-under-securitisation-regulation*
[2] Joint Committee Q&A relating to the Securitisation Regulation (EU) 2017/2402 available on *https://www.esma.europa.eu/sites/default/files/library/jc_2021_19_jcsc_qas_on_securitisation_regulation.pdf*
[3] Joint Committee advice on the review of the securitisation prudential framework available on *https://www.esma.europa.eu/sites/default/files/library/jc_2022_65_-_jc_advice_on_review_of_securitisation_prudential_framework.pdf*

(ii) Risk retention

In order to align their interests with those of the investors, the originator, sponsor or original lender must retain a material net economic interest in the securitisation on an ongoing basis. Risk retention must meet the following additional requirements:

- the material net economic interest shall be not less than 5% of the ongoing nominal value of the tranches sold or exposures securitised and shall not be subject to any credit-risk mitigation or hedging;
- only one of the parties/roles must retain the material net economic interest (i.e., no split between the involved parties/ roles, yet several originators could share the risk retention) and, if no agreement is reached between the parties, the originator shall fulfil the risk retention obligation.

The Regulation introduces a conclusive catalogue of possibilities to meet the risk retention requirement and solely exempts exposures that are fully, unconditionally, and irrevocably guaranteed by public authorities. This catalogue, completed by a Regulatory Technical Standard ("RTS") on the risk retention requirements for securitisations published by EBA, specifies several aspects on the risk retention requirements and closely resembles the one applicable under the previously existing buy-side regulations.

The requirement for risk retention is similar to the ones under the Dodd-Franck Act in the United States but different in the details. Thus, a securitisation valid for US risk retention is not necessarily EU Regulation compliant. Therefore, some sponsors have developed dual compliant securitisations.

Furthermore, as mentioned above, changes for NPE securitisations have been made, including the risk retention to be calculated on the basis of 5% of the net (discounted) value of the securitised NPE exposures, as opposed to the nominal value. In addition, the servicer in an NPE transaction may also act as risk retainer.

(iii) Transparency

The transparency and due-diligence provisions of the Regulation are inherently linked since transparency should facilitate due-diligence. The Regulation establishes transparency as one of its main pillars and imposes transparency requirements concerning all types of securitisation, in order to allow investors to understand, evaluate and compare the operations.

Article 7 of the Regulation sets out transparency requirements for all securitisations, including private and non-STS transactions. Thus, they should not be mixed up with additional transparency requirements for transactions seeking the STS label. Under Article 7, each of the originator, the sponsor and the SSPE has to provide detailed quantitative and qualitative, static and dynamic information on the securitisation to its investors, to the competent authorities and, upon request, to potential investors. This includes, amongst others, to:

- provide the (potential) investors on a regular basis with sufficient information, e.g. on the underlying exposure and documentation;
- designate who among themselves will provide the required information;
- make this information available via a securitisation repository to provide the investors with a single and supervised source of the data necessary for performing their due diligence (except for private securitisations).

The ESMA published Level 2 Regulation on transparency requirements. The Level 2 Regulation introduced many very detailed reporting templates that have to be used. Public securitisations (i.e. having issued securities listed on an EU-regulated market) need to complete more templates than a private securitisation and have to report to a securitisation repository. Nevertheless, private securitisations also need to report under the predefined templates even if the investor would not require it. ESMA has also published Questions and Answers (Q&As) on the Regulation with regards to the transparency requirements and which are updated from time to time[1].

It has to be noted positively that, in its report on the functioning of the Securitisation Regulation[2], the European Commission requests ESMA to draw up a dedicated template for private securitisation transactions in order to simplify the respective transparency requirements while still providing sufficient information to supervisors. A timeline for the drafting or finalisation of this template is not set yet.

Public securitisation transactions have report to a securitisation repository, i.e. a legal person that centrally collects and maintains the records of public securitisations. The securitisation repository provides investors with a single and controlled source of data necessary for the appropriate exercise of due-diligence. Currently, European DataWarehouse GmbH, Germany, and SecRep B.V., The Netherlands, are registered as securitisation repository.

(iv) Ban on re-securitisations

As mentioned above, the Regulation states that the underlying exposures used in a securitisation shall not include any securitisation positions. Under Article 8 of the Regulation, re-securitisation is generally prohibited but certain exceptions may be granted by the competent authority, e.g. when wind-up issues or NPEs are part of the transaction.

(v) Criteria for credit-granting

In order to avoid "credit origination to securitise" (equaling pre-crisis "originate-to-distribute"-models), originators, sponsors and original lenders shall apply the same sound and well-defined criteria for credit-granting which they apply to non-securitised exposures. Certain exceptions apply to NPE originators having purchased the exposures themselves from third parties originators having purchased the exposures themselves from third parties.

6.1.2 Specific framework for STS securitisations

In addition to the general framework described above, the Regulation also introduces a specific framework for "high quality" securitisation in order to establish a more risk-sensitive prudential framework for STS securitisations. Banks and insurers investing in STS securitisations benefit from lower capital requirements.

In order to be considered as STS, an EU securitisation must fulfil numerous criteria relating to simplicity, transparency and standardisation as mentioned under Chapter 4 of the Regulation. Those criteria are further interpreted by guidelines published by the EBA.

This does not mean that an STS securitisation position is free of risks, but it indicates that a prudent and diligent investor will be able to properly analyse the risks involved in the securitisation.

Requirements for STS in addition to those applicable to all EU securitisations

As mentioned above, a STS securitisation must fulfil numerous criteria relating to simplicity, transparency and standardisation. The figure below shows a selection of these criteria.

Originally, synthetic securitisations were fully excluded from the STS regime. Pursuant to Section 2bis of the Regulation and in order to maintain one of the purpose of the CMU consisting in the revival of the European economy through the capital markets, the Regulation now enables on-balance sheet synthetic securitisations to qualify as STS transactions. So-called arbitrage securitisations remain ineligible for the STS label. This implies a preferential capital requirements treatment for such on-balance sheet synthetic transactions if STS and certain other requirements (sometimes referred to as "STS+") are fulfilled.

[1] Question and Answers on the Securitisation Regulation (version 9) dated 19 November 2021 available on *https://www.esma.europa.eu/sites/default/files/library/esma33-128-563_questions_and_answers_on_securitisation.pdf*
[2] Report from the Commission to the European Parliament and the Counciel on the functioning of the Securitisation Regulation dated 10 October 2022 available on *https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52022DC0517*

In addition to fulfilling the STS criteria presented above, further conditions must be met, for example:

- Originator, sponsor, and SSPE (i.e. the securitisation vehicle) must be established in the European Union, e.g. in Luxembourg;
- All STS securitisations must be published in a list on the official website of the ESMA;
- Originators and sponsors shall jointly notify ESMA of a new STS securitisation. This notification shall include an explanation by the originator, the sponsor, and the SSPE on how each of the STS criteria has been complied with or a statement that the compliance with the STS criteria was confirmed by an authorised third party, like the STS Verification International GmbH, Frankfurt.

Upon communication by the SSPE to ESMA, the instruments are listed in a centralised web data repository listing all STS securitisations, both private and public ones. This website is accessible to everyone yet disclosing less information about private securitisations. Until the end of March 2023, 685 STS securitisations have been included in this list (while 125 have been cancelled in the meantime, partly because the UK no longer belongs to the EU). This means 48 new STS transactions have been registered within the preceding twelve months and a total of 560 STS securitisations outstanding as at that date. Only around 34% are public transactions (7% less than prior year), 66% are private deals. The vast majority of the transactions (88%) is done as true-sale or traditional securitisation, with the remainder (12%) being synthetic STS securitisations (which is only possible since 2021). With regards to the assets class and similar to prior year, about 28% are linked to autoloans/leases, 35% relate to trade receivables,11% residential mortgages, 11% SME loans and 10% to consumer loans. The remaining 5% have not specified the asset class.

Figure 31: STS criteria

Simplicity	Transparency	Standardisation
Portfolio and cashflows • True-sale only* • No active management (eligibility criteria) • Homogeneous asset type • No re-securitisation • No defaulted exposures • Cashflows not substantially dependent on sale of asset • At least one payment made • …	Investor data availability • Historical (≥5yrs) default and loss performance data • Sample of exposure independently verified • Liability cash flow model linked to exposure • Originator and sponsor responsible for transparency (incl. STS notification and quarterly investor reporting) • …	Structural elements • Risk retention satisfied by originator, sponsor original lender • Interest and currency risk mitigated • Roles and responsibilities of transaction parties, esp. servicer, clearly described • Remedies and actions in case of delinquency/default of debtors or conflicts of investors predefined • …

* since 2021, on-balance synthetic securitisations allowed

Third party verification

Originator, sponsor and SSPE may use the service of an authorised third party to verify whether a securitisation complies with the STS criteria. However, the use of such service shall under no circumstances affect the liability of the originator, sponsor and SSPE in respect of their legal obligations under the Regulation nor the due-diligence obligations imposed on institutional investors. Third parties undertaking to offer this kind of verification undergo a thorough licensing process and are supervised by ESMA. Currently, STS Verification International GmbH and Prime Collateralised Securities (PCS) UK Limited have acted as third party verification agents for STS structures.

Competent authorities and sanctions

As securitisation involves several parties, it is important to clarify which supervisory authority will be responsible for the supervision of each party and action in the securitisation process. The Regulation attributes some powers directly to competent authorities, while it confers the power to assign other supervision duties to the Member States (for Luxembourg, the CSSF and the CAA are the designated competent authorities).

ESMA is tasked with the role of assuring consistent implementation, deciding in some instances when competent authorities cannot agree and monitoring the securitisation markets for the commission. As each securitisation can involve parties from different sectors (banking, insurance, asset management) and different countries, competent supervisory authorities will have to communicate and collaborate in order to find common approaches on securitisation matters in order to avoid escalations, which may prolong processes in some cases.

The Regulation also contains provisions regarding sanctions for malpractice. Sanctions are imposed in case of wrongdoing by any party involved in the securitisation process, as this is considered essential for the functioning and the credibility of the system.

In particular, if a competent supervisory authority ascertains that a securitisation previously considered STS does no longer fulfil requirements, the product will be removed from the website listing STS products and a financial sanction will be imposed on the originator (the financial penalty is minimum EUR 5 million, or up to 10% of the annual turnover of the offender at individual or group consolidated level). The originator may also be banned temporarily from issuing STS products, not mentioning the significant reputation loss.

Member States also have the possibility to introduce criminal charges, but they are not obliged to do so.

6.1.3 Impact on Luxembourg

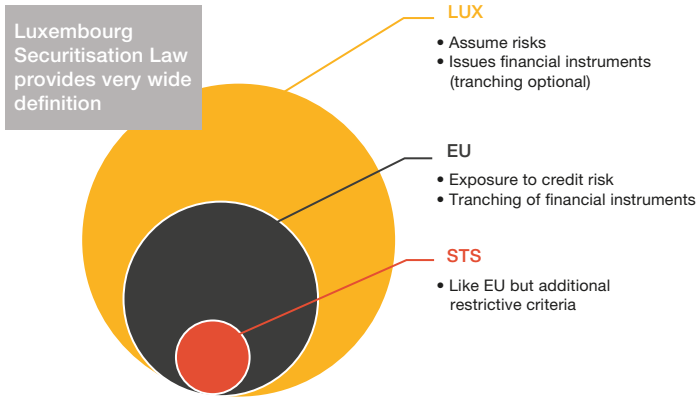
According to the securitisation definition in the Luxembourg Securitisation Law, not all Luxembourg securitisation transactions meet the definition of a securitisation as per the Regulation, and therefore the Regulation does not apply to all Luxembourg securitisations. On the other hand, Luxembourg vehicles performing securitisation under the EU definition may not have opted for the Luxembourg Securitisation Law.

A Luxembourg securitisation vehicle may acquire or assume any risk (and not only credit risk as per the Regulation) and issue financial instruments linked to this risk, while tranching is not mandatory (contrary to the Regulation). Contrary to the general rule of the Regulation, financial instruments issued by Luxembourg securitisation vehicles may also be sold to retail clients, while this implies supervision by the CSSF if certain conditions are met (see Chapter 3 above).

Thus, a Luxembourg securitisation vehicle may be structured in three possible ways: “LUX-only”, “EU” or “STS” (see Figure 32 below).

As such, Luxembourg remains a very flexible and attractive environment, providing legal certainty and an interesting product toolbox. In addition, Luxembourg Securitisation Law allows for the creation of compartments or sub-funds under one legal entity.

Figure 32: Impact of EU Securitisation Regulation on Luxembourg



LUX-only Securitisation	EU Securitisation	STS Securitisation
Subject to Luxembourg Securitisation Law but out of scope of the Regulation; because of either securitising a risk other than credit risk or by not tranching the securities issued. For regulatory purposes potentially rather treated similar to a corporate bond than securitisation. This may incur different (regulatory) treatment for investors and less obligations for originator and sponsor as would be prescribed by the Regulation.	Securitises credit risk and issues tranched, subordinated securitisation positions. May also be subject to Luxembourg Securitisation Law. This would imply that the above-mentioned requirements (e.g. risk retention, transparency, due-diligence) need to be complied with.	Fulfils definition of EU Securitisation, i.e. securitises credit risk and issues tranched, subordinated securitisation positions. It may also be subject to Luxembourg Securitisation Law but does not have to. In addition, the STS criteria mentioned above need to be complied with.

6.2 Regulatory treatment of securitisation for bank and insurance investors

6.2.1 Capital requirements for banks

The framework of the Capital Requirements Directive ("CRD V") and the Capital Requirements Regulation ("CRR II") covers the minimum capital requirements and the methodology for calculating the capital adequacy, operational requirements, and disclosure by credit institutions. It defines ratios, such as the Liquidity Coverage Ratio, the Net Stable Funding Ratio, and the Leverage Ratio. Additionally, risk management and supervision provisions are described. This also includes the treatment of securitisation positions held by credit institutions. In the context of updating the EU securitisation framework, Regulation (EU) No 2017/2401 (amending Regulation (EU) No 575/2013) addresses several shortcomings of the former CRD IV framework, as for example, a reliance on external ratings, relatively low risk weights for highly-rated securitisation tranches and high risk weights for low-rated tranches, as well as insufficient risk sensitivity.

Minimum capital requirements for securitisation positions

There are two cornerstones in relation to the regulatory approach for credit institutions calculating their capital requirements of securitisation transactions.Firstly, the overall approach of the amended CRD V is based on economic substance rather than the legal form. Therefore, the analysis of securitisation transactions follows the same principle.

Secondly, a credit institution needs to broadly assess its securitisation exposures, i.e. not only the related credit risk exposure but also structural elements (such as early amortisation and clean up calls for instance) as well as commercial aspects such as implicit support.

Operational requirements

There are detailed operational requirements that an originating credit institution has to comply with in order to be able to calculate its capital requirements. The operational requirements are divided into requirements for traditional securitisations and synthetic securitisations, those related to clean-up calls, those for the use of credit assessments, and those for inferred ratings.

Treatment of capital exposures

The treatment of capital exposures for a credit institution is defined on the exposure rather than the role played by the credit institution. Credit institutions are required to hold capital against all of their securitisation exposures, including those arising from:

- the provision of credit risk mitigating a securitisation transaction;
- investments in ABS;
- retaining a subordinated tranche;
- extending a liquidity facility;
- granting a credit enhancement and providing of implicit support to a securitisation; and
- repurchased securitisation exposures.

In summary the amended CRD V framework implements a hierarchy of three approaches (it is still compulsory to use the very same approach as selected by the credit institution for treating the underlying portfolio of assets) in the following order:

a) Securitisation Internal Ratings Based Approach – "SEC-IRBA"

The default option to calculate the capital requirements for securitisation exposures is the SEC-IRBA using the Simplified Supervisory Formula Approach ("SSFA"). Starting point are the capital requirements for the risk-weighted exposure amounts (including the amount of expected and unexpected losses

associated with all underlying exposures) that would be calculated as if the underlying exposures had not been securitised. In addition, the SSFA then assigns risk weights to specific tranches based on the subordination level and thickness of the tranche within the securitisation structure in order to take into account the relative seniority of the securitisation exposure.

The calculated risk-weighted exposure is subject to a minimum floor risk weight of 15%. For STS securitisations, the risk weight floor for senior securitisation positions is 10%. The maximum risk weight is 1,250%.

b) Securitisation Standardised Approach – "SEC-SA"

Where the SEC-IRBA may not be used because sufficient information on the underlying exposures is not available or competent authorities have precluded the use because securitisations have highly risky/complex features, the SEC-SA shall be used. Under this method the standardised approach, as described below, is used to calculate the capital requirements in relation to the underlying exposures of a securitisation "as if they had not been securitised". SEC-SA may be used for a re-securitisation position with a risk weight floor of 100%. For securitisation positions, the range of risk weights is the same as under the SEC-IRBA.

c) Securitisation External Ratings Based Approach - "SEC-ERBA"

In the third method in the hierarchy, the capital requirements are calculated by applying a risk weight to a securitisation tranche based on its external rating. The approach consists of calculating a risk-weighted asset amount of the exposure based on an existing table in the framework. Mapping the eligible rating agencies' external ratings to credit-quality classes provided by the CRD V is part of the responsibility of the EBA.

Disclosure requirements for securitisation

As securitisation exposures form part of the risk-weighted assets, credit institutions have to disclose inter alia information regarding:

- a description of the institution's objectives in relation to securitisation activity;
- the nature of other risks, including liquidity risk inherent in securitised assets;
- the type of risks in terms of seniority of underlying securitisation positions and in terms of assets underlying the securitisation positions assumed and retained with re-securitisation activity;
- the different roles played by the institution in the securitisation process;
- a description of the processes in place to monitor changes in the credit and market risk of securitisation exposures;
- a description of the institution's policy governing the use of hedging and unfunded protection to mitigate the risks of retained securitisation exposures;
- the approaches to calculating risk-weighted exposure amounts that the institution follows for its securitisation activities;
- the types of vehicles that the institution, as sponsor, uses to securitise third-party exposures, as well as a list of the entities that the institution manages or advises and that invest in either the securitisation positions that the institution has securitised or in vehicles that the institution sponsors;
- a summary of the institution's accounting policies for securitisation activities;
- the names of the External Credit Assessment Institutions used for securitisations and the types of exposure; and
- the total amount of outstanding exposures securitised by the institution.

Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR)

The CRD V framework does not only cover capital requirements at investor level. Banks are also obliged to respect certain liquidity needs with respect to their assets. Despite the fact that securitisation exposures may generate inflows and outflows, they can even – and under certain conditions – be recognised as eligible liquid assets for calculation of the liquidity buffer (expressed as LCR and NSFR).

6.2.2 Capital requirements for (re-)insurance companies

Since the Solvency II Directive and its delegated acts entered into force in 2016, Luxembourg securitisation vehicles have become even more attractive for insurers and reinsurers. All insurers and reinsurers have to apply the Solvency II requirements which includes the solvency capital requirements as well.

Equity-type investments - especially in the alternative sector - could be less attractive compared to debt products with the same underlying, as these may require different amounts of solvency capital at the insurers' level depending on their design and features. Therefore, the use of securitisation vehicles instead of mere fund structures could be an attractive choice.

For debt instruments, e.g. bonds or notes issued by a securitisation vehicle, the question of a good external rating becomes a significant factor in determining the stress factor of an investment, and thus ultimately the amount of the solvency capital.

For any "collective investment undertaking" (i.e. UCITS or AIF), "other investment packaged as a fund", or "securitisation", Solvency II foresees a "look-through" approach. This means that the Solvency Capital Requirement ("SCR") shall be calculated by analysing each of the underlying assets. In order to avoid this "look-through" obligation, the securitisation vehicle shall not meet either of the three definitions. This is relatively obvious for any fund-like definition (except for securitisation vehicles qualifying at the same time as AIF) but may be more difficult with regards to the "securitisation" definition of Solvency II.

In a first step, it has to be assessed whether the transaction should be considered as "securitisation" under Solvency II, since the definition differs from the one of the Luxembourg Securitisation Law. Based on the EU Securitisation Regulation, Solvency II requires a transaction to securitise credit risk associated with an exposure or pool of exposures and to issue tranched securities or financial instruments. A securitisation vehicle set up according to the Luxembourg Securitisation Law can be structured without tranches or securitise other than credit risk and may thus not qualify as securitisation in the meaning of Solvency II, depending on the individual structural elements. This would normally entail an easier capital requirements treatment under Solvency II.

Furthermore, the look-through approach shall also apply to indirect exposures to market risk other than collective investment undertakings and investments packaged as funds, toindirect exposures to underwriting risk and toindirect exposures to counterparty risk.

Therefore, when structuring the debt instrument issued by a securitisation vehicle, one also needs to consider whether the instrument has an "indirect exposure to market risk" as this would consequently lead to a "look-through" requirement. Only securitisation vehicles issuing debt securities set-up without direct link or 1:1 relationship to the market risk of the underlying portfolio or otherwise creating an indirect market risk exposure for the investor may be considered as debt instruments without any "look-through" obligation.

In conclusion, we believe that a Luxembourg securitisation vehicle has become even more attractive to European insurers under Solvency II. Properly structured and with a good external rating, it ultimately leads to a lower amount of underlying required capital at the insurers' level.

6.3 Packaged Retail and Insurance-based Investment products (PRIIPs) regulation

General

Since 1 January 2018, the Packaged Retail and Insurance based Investment Products ("PRIIPs") regulation has entered into force in the European Union. This Regulation requires that all "packaged" financial products sold to retail investors have a Key Information Document ("KID").

Very limited flexibility is allowed to manufacturers for drawing up the KID as the template, the form, the narratives, and the other contents have been defined in the appendices of the RTS.

On 3 February 2021, ESAs released their final report on draft amendments to the PRIIPs Technical Standards for KIDs . The amendments mainly target the methodology to define future performance scenarios and disclosure of past performance for UCITS and AIFs. This amended Regulatory Technical Standards entered in force on 1 January 2023.

Information disclosed in the KID are:

- product and manufacturer's names, code, supervisory authority;
- a comprehension alert in case of complex product;
- the investment objectives and the means to achieve it;
- the intended retail investors (or "target market");
- the recommended holding period or product's maturity;
- a risk indicator from 1 to 7 combining market and credit risk;
- future performance under different market conditions;
- the breakdown of the costs including transaction costs;
- the impact of the costs on the product's future performance;
- the process to lodge a complaint;
- some explanations in case of default of the manufacturer

Finally, the KID shall be translated in one of the official languages of the country where the PRIIP is distributed.

In the context of securitisation

Firstly, by "packaged", the EU Regulator means financial products "where the amount repayable to the retail investor is subject to fluctuation because of exposure to reference values, or subject to the performance of one or more assets which are not directly purchased by the retail investor. [...] Financial instruments issued by special purpose vehicles that conform to the definition of PRIIPs should also fall within the scope of this Regulation."

Secondly, by "retail" investors, PRIIPs refer to the definition under Market in Financial Instruments Directive ("MiFID"). Briefly, all non-professional investors including well-informed, semi-professional, or high net worth individuals are considered as "retail" investors by the PRIIPs Regulation[1].

In this context, we could see two situations where securitisation vehicles could be impacted by PRIIPs and we will distinguish the situation between direct (requirement to prepare a KID) and indirect impact (requirement to provide information).

[1] Article 6 of Regulation (EU) 1286/2014

1) Direct impact

If securities issued by securitisation vehicles are sold directly to non-professional investors in Europe, a full PRIIPs KID will be required. The KID will need to be finalised and provided to the investors before the transaction. It will also require publication on a website and monitoring. Indeed, any material changes in the KID should trigger immediate update and publication of the document.

2) Indirect impact

When a PRIIP (e.g. an investment fund) invests in securitisation vehicles, they will require cost information to draw the KID. Indeed, where the investments of a PRIIP (i.e. the fund) are not producing a KID, it will be necessary to obtain KID equivalent information for the direct investments (i.e. the securitisation vehicle). All the cost paid by the vehicle during the past year will have to be provided to the fund.

As stated above, a different situation can occur in the specific case of securitisation vehicles, therefore an assessment of potential impact of PRIIPs regime will have to be performed before selling the securities issued by the securitisation vehicles.

6.4 Securitisation in the context of the AIFMD

The Alternative Investment Fund Managers Directive 2011/61/ EU provides a harmonised regulatory and supervisory framework within the EU, as well as a single EU market for managers of AIF. It sets rules regarding the marketing of AIF and the substance and organisation of their managers. In Luxembourg, the AIFMD was transposed into the national Law of 12 July 2013 on alternative investment fund managers (the "AIFM Law").

As the AIFM Law does not generally apply to "securitisation special purpose vehicles", the question was raised as to whether Luxembourg securitisation vehicles fall within the scope of the AIFM Law and thus qualify as an AIF. The response of the CSSF has clarified this question in their Q&A on securitisations.

The issue was that the AIFM Law refers to entities whose sole purpose is to carry out a securitisation within the meaning of Article 1 (2) of Regulation (EC) No 1075/2013 of the ECB of 18 October 2013 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions, replacing Regulation (EC) No 24/2009 (ECB/2008/30). Compared to the Luxembourg Securitisation Law, this EC regulation provides a much narrower definition of securitisation. This definition is also different to the one defined in the EU Securitisation Regulation.

The CSSF has published three criteria to define whether a securitisation vehicle is qualified as an AIF or not:

1. Securitisation vehicles falling within the definition of "securitisation special purpose entities" (structures de titrisation ad hoc) within the meaning of the AIFM Law may not be considered as AIFs within the meaning of the AIFM Law, as Article 2(2)(g) of the AIFM Law provides that securitisation special purpose entities are excluded from its scope.

Securitisation special purpose entities are defined as entities whose sole object is to carry out one or more securitisation transactions within the meaning of the aforementioned ECB regulation. The latter defines "securitisation" as "a transaction or scheme whereby an asset or pool of assets is transferred to an entity that is separate from the originator and is created for or serves the purpose of the securitisation and/or the credit risk of an asset, or pool of assets, or part thereof, is transferred to the investors in the securities, securitisation fund units, other debt instruments and/or financial derivatives issued by an entity that is separate from the originator and is created for or serves the purpose of the securitisation, and:

a) in case of transfer of credit risk, the transfer is achieved by:

- the economic transfer of the assets being securitised to an entity separate from the originator created for or serving the purpose of the securitisation. This is accomplished by the transfer of ownership of the securitised assets from the originator or through sub participation, or
- the use of credit derivatives, guarantees or any similar mechanism

and

b) where such securities, securitisation fund units, debt instruments and/or financial derivatives are issued, they do not represent the originator's payment obligations.

2. Whether or not they fall within the definition of securitisation special-purpose entities pursuant to the AIFM Law, securitisation vehicles that issue only debt instruments shall not qualify as AIFs. It seems that it was not the EU lawmakers' intention to qualify undertakings issuing debt instruments as AIFs.

3. Whether or not they fall within the definition of securitisation special-purpose entities pursuant to the AIFM Law, securitisation undertakings that are not managed in accordance with a defined investment policy pursuant to Article 4 (1)(a) of the AIFMD shall not qualify as AIFs. Subject to criteria set out in the ESMA guidelines, securitisation undertakings that issue structured products offering synthetic exposure to assets (equities, commodities or indices thereof), as well as acquire underlying assets and/or enter into swaps with the sole purpose of hedging the payment obligations arising from the issued structured products, shall

not be considered to be managed in accordance with a defined investment policy.

It should be noted that securitisation undertakings are required to carry out a self-assessment to determine whether they qualify as an AIF

Consequently, Luxembourg securitisation vehicles which

a) securitise credit risk, or
b) issue only debt instruments, or
c) are not managed in accordance with a defined investment policy

do not qualify as AIF.

Therefore, the vast majority of securitisation vehicles established in Luxembourg are outside the scope of the AIFM Law. In particular, the majority of the authorised Luxembourg securitisation companies established as platforms issuing structured products through many compartments do not fall within the scope of the AIFM Law. For a securitisation fund issuing only an immaterial number of fund units and the residual funding via debt, in our view, it is legitimate not to consider the securitisation fund as an AIF. It is the responsibility of the securitisation fund's management company to decide whether the securitisation fund is an AIF or not.

Nevertheless, there are a few securitisation vehicles which qualify as an AIF. This is particularly the case if the securitisation vehicle is closely related to a fund in a two-tier structure (see Chapter 3.2.5), i.e. the securitisation vehicle acts as an acquisition vehicle purchasing the assets and the related fund acts as an issuing vehicle and finances the securitisation vehicle.

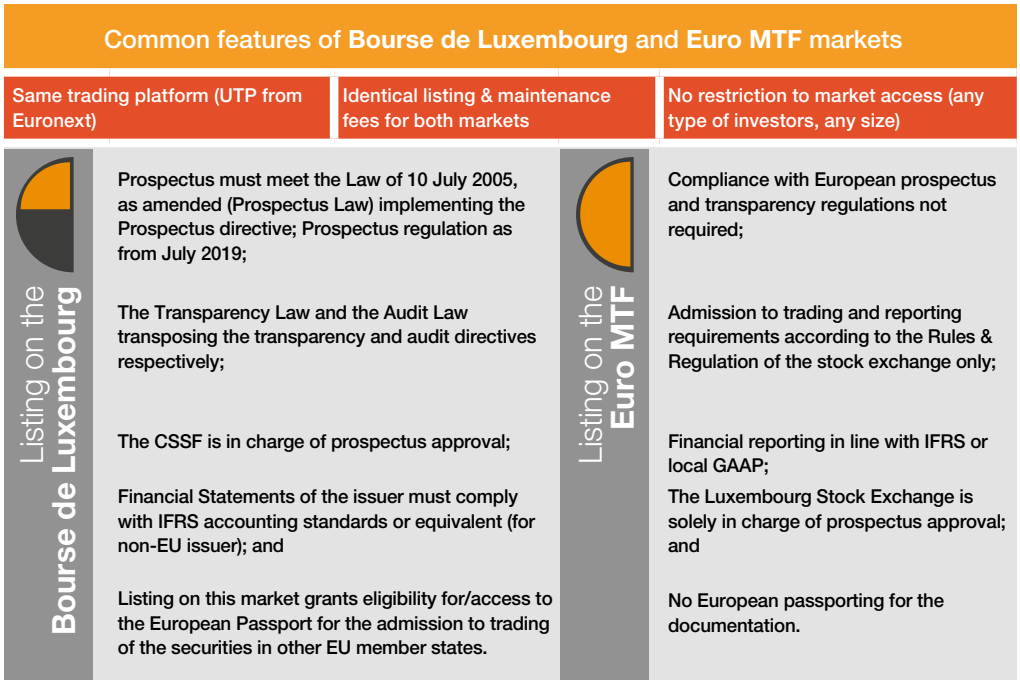
6.5 Distribution and listing

6.5.1 Listing in Luxembourg

There are two possible ways of listing as the Luxembourg Stock Exchange ("LuxSE") operates two markets: (1) the EU-regulated market, the "Bourse de Luxembourg" market, and (2) the exchange-regulated market "Euro MTF" (see Figure 33).

For issuers who are looking for a sound regulatory framework but do not require an European passport as defined in the EU Prospectus Regulation, the exchange-regulated market Euro MTF often meets their financing needs. This market is outside the scope of the Luxembourg Prospectus Law and the Luxembourg Transparency Law, both leading to specific disclosure requirements for the issuing entity. There are no restrictions on the type of securities to be listed on both markets. However, issuers will need to comply with different requirements according to the chosen market. Official listing requirements are applicable to both markets. For issuers looking for visibility and for whom admission to trading is not prerequisite, the LuxSE offers the possibility to admit securities to its official list without admission to trading. These securities will be displayed on the LuxSE Securities Official List ("LuxSE SOL"), a dedicated section of the entire LuxSE's official list.

Figure 33: Common features of Bourse de Luxembourg and Euro MTF markets



Furthermore, disclosures required in the annual accounts will differ. Entities having securities listed on an EU-regulated market will always have to publish a management report, a corporate governance statement and a remuneration report and must also be ESEF compliant. While consolidated accounts (for their own specificity securitisation vehicles normally do not prepare these) would have to be drawn up under IFRS, stand-alone accounts can still be published under local GAAP. Nevertheless, they should be accompanied by a cash flow statement. The Luxembourg Stock Exchange features two Professional Segments, available on the EU-regulated and the Euro MTF market. Issuers targeting professional investors can apply to have their financial instruments admitted to trading in the new segments. Admitted securities will not be accessible for retail investors as trading on the Professional Segments is only allowed between professional investors. Advantages of being admitted to trading on the Professional Segments, among other things, consist of having:

- Less onerous information requirements than those applying to non-equity securities offered to retail investors;
- No requirement to include a summary in the prospectus;
- More flexible language requirements;
- No requirement to identify, and communicate to distributors, a compatible target market of investors and periodically review that target market;
- No requirement for KID.

6.5.2 Prospectus disclosure obligations

Once a securitisation transaction has been structured, questions regarding the distribution of the securities issued may arise. Whether a prospectus will need to be published will depend on the distribution structure used (i.e. who the potential investors are, whether they are institutional or retail, in which and how many countries the securities should be sold, and whether or not a listing on a regulated market is demanded).

The requirements governing the publication of a prospectus when securities (debt and equity securities) are offered to the public or admitted to trading, are laid down in the EU Prospectus Regulation and transposed into Luxembourg legislation by the Luxembourg Prospectus Law.

The Prospectus Regulation responds to the following main objectives:

- defining and harmonising the disclosure requirements to obtain a single EU passport. Thus, a prospectus approved by the authority of one Member State is valid within other Member States;
- improving the quality of information provided to investors by companies wishing to raise capital in the EU;
- lowering the cost of capital;
- setting out the conditions to be met by issuers when offering securities to the public in the EU;
- specifying minimum disclosure requirements for different products and according the type of targeted investors;
- ensuring that interested parties have access to prospectuses.

The Prospectus Law differentiates three different prospectus regimes: a “public offer of securities” and/or an “admission of the securities to trading on an EU-regulated market”, and “private placements”. Before having a deeper look at the regimes, “public offering” should be further defined. Under the Prospectus Law, any communication to persons in any form and by any means presenting sufficient information on the terms of the offer and the securities to be offered, so as to enable an investor to decide to purchase or subscribe to these securities will constitute a “public offer” and, consequently, require a prospectus to be published. The same applies to securities admitted to listing on an EUregulated market as well as placements of securities through one financial intermediary.

However, according to Article 4 (1), the obligation to publish a prospectus does not have to be met for the following distribution forms, which should be considered as “private placements”:

- offers to qualified investors only; and/or
- offers to less than 150 individuals or legal entities per EU or EEA Member State other than qualified investors; and/or
- offers to investors who subscribe at least EUR 100,000 per investor; and/or
- offers where each security has a nominal value of at least EUR 100,000.

In connection with private placements, there are no further requirements described in the Luxembourg Prospectus Law.

Concerning the information required to be made available to potential investors within private placements, the Luxembourg Prospectus Law only states that all material information should be provided to them. However, it does not explicitly determine what information qualifies as “material”. Because of the liability attached to a prospectus, the private placement memorandum should include any material information necessary for investors to make an informed assessment of the securities offered.

Contrary to private placements, any entity intending to make a public offer of securities in Luxembourg must notify the CSSF in advance and must publish a prospectus (or, as the case may be, a simplified prospectus), which must be approved by the CSSF. The Prospectus Law distinguishes three regimes (summarised in Figure 34):

i. The first regime applies to “public offers”of securities within the scope of the Prospectus Regulation and offering to the public or admission to trading on an EU-regulated market by corporate issuers, which, in Luxembourg, is the Bourse de Luxembourg market segment of the LuxSE. In this case, the CSSF is the competent authority to ensure that the provisions of the Luxembourg Prospectus Law are enforced, i.e. that the prospectuses and any related supplement to them are approved where Luxembourg is the issuer’s home Member State. The filings of documents and notices are also within the supervision of the CSSF. If a listing on another EU-regulated market is also required, the CSSF is also the competent authority to approve the prospectus (“European passport”) as home Member State authority.

The prospectus must include all the necessary information on the particular nature of the issuer and the securities offered to the public, according to the Commission Delegated Regulation (EU) 2019/979 of 14 March 2019 and the Commission Delegated Regulation (EU) 2019/980 of 14 March 2019, as amended regarding the information contained in prospectuses, format incorporation by reference and publication of such prospectuses. This enables investors to make informed assessments of the assets and liabilities, financial position, profit and losses, and prospects of the issuer and of any guarantor, as well as of the rights attaching to such securities. The information shall be provided in a format that is easy to analyse and understand. Such a prospectus will also need to contain a summary conveying the essential characteristics and risks associated with the issuer, any guarantor and the securities, unless the securities offered are wholesale debt securities (securities issued with a minimum denomination of EUR 100,000 deemed to be issued to "sophisticated" or "professional investors"). In the case of a simplified prospectus, which is described below, a summary is not required

ii. The second regime applies to "offering of securities and admissions to trading outside the scope of the Prospectus Regulation." In case of public offering of these securities, simplified prospectuses have to be drawn up (however with the same private placement exceptions as described above). These securities mainly include: (a) securities issued by EU Member States, their regional or local authorities or related entities; (b) "small" issues (less than EUR 1 million) and certain debt securities issued by credit institutions for a total amount of less than EUR 75 million; and (c) money market instruments with a maturity at issue of less than 12 months. As with the first regime, the CSSF is the competent authority for the approving of simplified prospectuses and any related supplement to the prospectuses. Simplified prospectuses, however, do not benefit from the European passport.

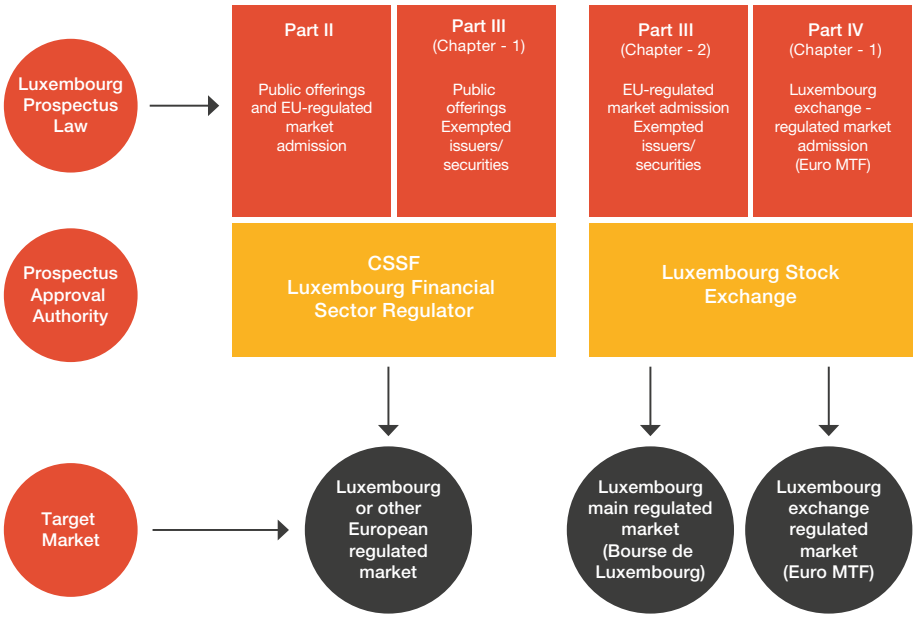
In case of trading on a Luxembourg regulated market, the LuxSE is the competent authority for approving of simplified

prospectuses, as well as admitting these securities for trading on an EU-regulated market that it operates. The simplified prospectus must also include all information necessary to enable investors to make an informed assessment of their investments, e.g. annual financial statements and the corporate structure details.

iii. The third regime deals with admitting securities for trading on a market not set out on the list of EU-regulated markets published by the EC. For admission to the Euro MTF market, LuxSE is the competent authority and its Rules and Regulations apply. However, they may not be more restrictive than those applicable on an EU-regulated market. For example, an issuer would have to provide documentation containing the characteristics of the notes (maturity, rank of subordination, interests/coupons, description of the activity of the issuer etc.).

The EU Prospectus Regulation which has superseded the EU Prospectus Directive has mainly simplified the prospectus' format and content in order to make it easier and cheaper for smaller companies to access capital while maintaining a strong level of investor protection and also offering new possibilities for companies to diversify their financing. The old regime provided for a number of exemptions from the obligation to publish a prospectus for public offers which remain largely the same but have been extended. In addition, some of the existing exemptions of preparing a prospectus for admission of securities to trading on an EU-regulated market have been partly revised or extended.

Figure 34: Prospectus Law requirements



7 Governance aspects

7.1 Anti-Money Laundering obligations

The anti-money laundering and counter-terrorist financing ("AML/CTF") regulatory landscape has evolved over the past few years. The expectations of the public for more transparency and the requirements set by the regulators have strengthened the pressure on the financial professionals operating on the Luxembourg market. With the announcement of the new EU AML Package, which includes wide-ranging EU AML Regulations, Directives and Guidelines, this trend shows no sign of stopping, and risks to regulation and reputation continue to represent major concerns for a rising number of company board members.

Sanctions and fines steadily increase in size and number and are imposed by national supervisory authorities and judges for not respecting anti-money laundering and anti-terrorist financing duties. The risk of damage to the reputation of financial players is considered a priority on the agenda of directors and stakeholders. In order to regain reputation and trust, governments, regulators, and financial players worldwide have launched important initiatives to control financial systems more efficiently.

In Luxembourg, the regulatory landscape is mainly composed of (a) the Law of 12 November 2004 (the "AML Law"), amended on 25 March 2020 to transpose the 5th EU AML Directive and lately in July 2022, (b) the CSSF Regulation N° 12-02 of 14 December 2012 amended in August 2020, (c) the Grand-Ducal Regulation of 1 February 2010 amended in October 2022, (d) the CSSF Circular 17/650 issued in 2017 as amended by CSSF Circular 20/744 and addressing the tax crimes as primary offences, and (e) finally the Law of 13 January 2019 ("RBE Law") introducing the national central register of beneficial owners (so-called "RBE"). Comprehensive guidelines for the establishment of an appropriate risk-based approach, as suggested by the European authorities, are also part of this framework (CSSF Circular 21/782). All financial sector professionals are covered by this legislation, as well as, for example, insurance companies, notaries, auditors, casinos, attorneys-at-law, estate agents, tax and financial advisors, persons selling high value goods, providers of gambling services, and lately the virtual asset providers.

Securitisation vehicles are in scope of the AML Law (Art. 2, 6ter), but only in cases where they carry out service providers' activities with regard to companies and trusts. All the other types of securitisation vehicles are excluded from the scope of the AML Law. The majority of Luxembourg securitisation vehicles does not carry out such service provider activities. In contrast, they themselves receive services from service providers. In its ML/TF Sub-Sector Risk Assessment as updated in 2022, however, the CSSF acknowledged that as of December 2021, three regulated securitisation vehicles in Luxembourg were considered to act as "fiduciaires in a fiducie" in line with Article 1(8)(d) of the AML Law and were, therefore, indeed in scope of the AML Law.

Nevertheless, many service providers of securitisation vehicles, like domiciliation agents, paying agents, auditors, etc., must comply with the AML regulations and identify the securitisation vehicles' beneficial owners as well as analyse business connections and investigate the sources of funds. For example, in accordance with the Law of 31 May 1999, companies who have their registered offices at third-party addresses must conclude a domiciliation contract with a domiciliation agent. CSSF Circular 01/29 provides a minimal amount of information on such domiciliation contracts. Accordingly, the domiciliation agent is responsible for identifying the Board of Directors, the shareholders, and the ultimate beneficial owners, as well as monitoring transactions and checking the names of the persons identified against blacklists.

Who are the beneficial owners of a securitisation vehicle?

Or, to put it another way, who are the natural persons who directly or indirectly own or control a securitisation vehicle? The current legislation does not provide a clear answer to this question but requires financial sector professionals to perform and document their own analysis of the securitisation vehicle's beneficial ownership and to define the risk associated with all parties involved in the transaction. Since the RBE Law entered into force, professionals are also required to report such natural persons to the RBE. However, the usual techniques for identifying ultimate beneficial owners often fail for securitisation vehicles, as the shareholder(s) by design typically have no economic interest.

More specifically, the AML Law states that the beneficial owner is a natural person "who ultimately owns or controls" the entity.

This definition uses a threshold approach with first an indicative shareholding threshold of 25% or the control via a "sufficient percentage of the shares or voting rights or ownership interest" and second the identification of any person who controls the legal entity via other means. Where no natural person could be identified using these criteria, and after having exhausted all possible means to determine them, provided there are no grounds for suspicion it is not possible to identify a beneficial owner, the beneficial owner will be "any natural person who holds the position of senior dirigeant (manager)".

Usually, securitisation vehicles are only capitalised with the required minimum capital, which is brought in by foundations, like charitable trusts or Dutch "Stichtings". Obviously, these entities are not the beneficial owners of the securitisation vehicle's assets or cash flows from an economic perspective (refer to Figure 35 for an illustration of the cash flows and involved parties of a typical securitisation transaction). Such vehicles, where the share capital is neither held by natural persons nor commercial companies, are also referred to as orphan securitisation vehicles or orphan financial vehicle corporations ("FVCs").

In some other cases, the originator of the securitisation transaction might also be considered as the beneficial owner as he will indirectly control and benefit from the transaction.

Finally, following the definition of beneficial owners, the board members – being senior managers – might be considered as the beneficial owners of the vehicle.

The CSSF Circular 19/732 relating to clarifications on the identification and verification of the identity of ultimate beneficial owner(s) ("UBO(s)") aims to provide guidance to all professionals subject to the AML supervision of the CSSF on the practical implementation of the identification requirements of UBOs, as well as on the reasonable measures that should be taken to verify the identity requirements.

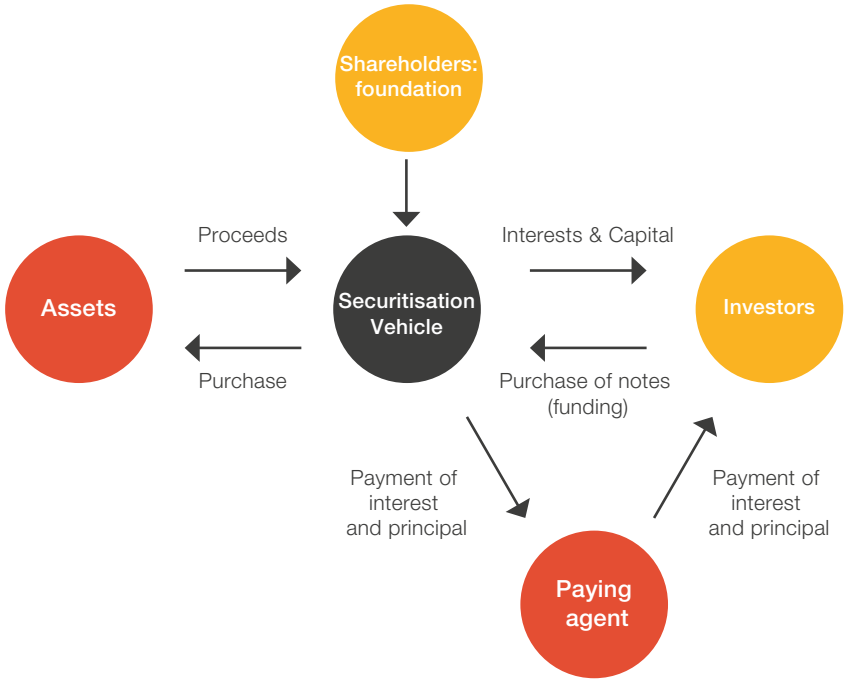
Securitisation can be a complex set-up involving several participants: arranger, originator, securitisation vehicle, custodian, paying agent, etc. There are ongoing discussions on the market on who should be identified as the UBO. Therefore, it is important that the analysis of the role and the risk associated with each participant is properly documented and kept up-to-date on a regular basis in order to ensure that the requirements to know the beneficial owner, if any, can be met by the service providers involved.

Who else may have to be identified from an AML/KYC perspective?

On a risk-based approach perspective, the securitisation vehicle has to be analysed on a case-by-case basis. There is no one way to define the risk and one way to mitigate it. In particular, it is not only a question of strictly defining individuals who respond to the legal definition of beneficial owners, it is above all identifying and (if applicable) verifying the identity of any persons or entity who could potentially benefit from a money laundering scheme by using the securitisation vehicle for illegal means.

While it is true that in some circumstances noteholders might not be considered as persons exercising control as they invest in debt and do not contribute to the share capital and have no voting rights and as such do not meet the legal definition of a beneficial owner, applying a risk-based approach would request the service providers to perform AML/KYC checks on the noteholders considering the risk associated with the securitisation vehicle.

Figure 35: Cash flow of a typical securitisation transaction



Who has to be reported as UBO in the Luxembourg beneficial owner register?

Additionally, the 4th and the 5th EU AML Directives require more transparency on the beneficial ownership of legal persons and arrangements. Today, corporate and legal entities already need to hold accurate and up-to-date information on their beneficial owners. With the AML Directives, the transparency in the identification of the beneficial owners increased as a national central register of beneficial owners, the RBE, was created in Luxembourg via the Law of 13 January 2019. All corporate and other legal entities including the securitisation vehicles incorporated in Luxembourg are required to upload information on their beneficial owners in this national central register. The filing is to be done electronically via the website of the LBR ("Luxembourg Business Register") and can be done in French, German, or Luxembourgish. Typically service providers such as the domiciliation agents of the securitisation vehicle will have to provide the required information to the RBE. It is the responsibility of the affected entities themselves, their beneficial owners, or any of their representatives to register the beneficial owners of the entities and provide required information: first and last names, nationalities, date and place of birth, country of residence, address, identification number, nature and extent of the beneficial interests held.

The above listed information in the RBE, previously accessible to anyone without specific conditions, is now only accessible to professionals within the meaning of Article 2 of the amended AML Law.

There is still a debate in the Luxembourg market on how to deal with orphan FVCs. The CSSF has equally raised some concerns about the trend to report Board members provided by a corporate services provider as controllers in the RBE. Although this issue is not specific to FVCs, it raises an important point regarding the extent to which the current RBE effectively reflects who controls and/or benefits from a securitisation structure.

As of today, there is no standard solution to this question and only a case-by-case analysis will show whether the charitable shareholder, the shareholders at compartment level, UBOs of noteholders or maybe other transaction parties should ultimately be reported to the RBE. In any case, it is necessary for the Board members of the securitisation vehicle to be able to demonstrate that a proper analysis was conducted and documented considering all the relevant information in order to identify the UBO for the purpose of RBE filing.

7.2 Responsibilities and liabilities of the Board of Directors/Managers

The Luxembourg Securitisation Law does not define specific duties or responsibilities for the members of the Board of Directors (or Board of Managers for an SARL, referred hereafter "directors") of the securitisation companies or management companies of securitisation funds. Therefore, their responsibilities are governed by general rules, mostly defined by commercial company law, commercial and civil law and, of course, the statutes of the relevant companies.

The core responsibility of directors is to take any action necessary or useful to realise corporate objectives, within the powers vested by law and by the individual company's articles of incorporation. In addition, the company will be represented relating to third parties and in legal proceedings by the directors. Regarding the day-to-day management of the business of the company and the power to represent the company, one or more directors (or officers, managers, or other agents) may have the right to act either alone or jointly. Some tasks may also be delegated to other transaction parties, e.g. the paying agent. Regarding transaction management, the directors usually approve and sign all transaction documents. Thus, they need to understand the structure, the expected cash flows and the underlying transaction documents in order to ensure that the securitisation vehicle's operations comply with the transaction documents. To ensure this, they liaise closely with the arranger, trustees, and lawyers involved. The directors are also responsible for the proper preparation of the annual accounts and any other reporting obligations (BCL, CSSF, interim accounts). In particular, this compromises an appropriate assessment of the valuation of the underlying assets, especially when it comes to accounting estimates. To prepare the company's annual accounts, the directors need to have a broad knowledge of the different accounting principles used, like IFRS and LuxGAAP.

As such, the directors are exposed to several liabilities. They are jointly liable for all damages adversely affecting the company and third parties resulting from breaching the commercial company law or the statutes. In addition, directors are liable for all possible avoidable administrative mistakes and/or failures made by management.

Of course, the directors can delegate certain tasks like accounting, asset servicing or valuation to third parties. However, the responsibility always remains with them.

Similarly, the independent auditor cannot limit his work to the level of the legal entity but needs to look beyond in cases where third party information is used to prepare significant elements of the company's annual accounts. Specifically, the International Standards on Auditing ("ISA") lays out the auditor's responsibilities for audits of annual accounts for which information provided by so-called "service organisations" (ISA 402) and "management's experts" (ISA 500) is used.

Therefore, both the auditor and the directors have a genuine interest and duty to gain sufficient understanding of and familiarity with the information obtained from third parties. This may include obtaining controls reports on the third party's processes (often so-called ISAE 3402 reports), procedure manuals, internal audit reports, on-site visits etc. Furthermore, plausibility checks on the appropriateness of the information received should be made, e.g. back-testing and variation analysis of third-party valuations.

7.3 Requirement to establish an audit committee

Under the EU Audit Legislation, each Public Interest Entity ("PIE") shall establish an audit committee. If certain criteria are met, Article 52 (2) allows for the delegation of these tasks to the administrative body. Furthermore, Article 52 (5c) of the Audit Law concerning the audit profession, states that any PIE whose sole business is to act as an issuer of asset backed securities are exempted from the requirement to establish an audit committee. However, if the exemption is used, the securitisation vehicle shall explain to the public the reasons why it considers that it is not appropriate for it to have either an audit committee or an administrative or supervisory body entrusted to carry out the functions of an audit committee. The law does not describe in detail where or to whom the securitisation vehicle shall make this disclosure. We recommend appropriate disclosure in the management report or in the corporate governance statement. Alternatively, the disclosure to the public can be made through other means such as publication in the RCSL or through the website of the securitisation vehicle. Such disclosure shall not be done through the notes to the annual accounts.

Below is a summary of the measures that relate to the role and responsibilities of audit committees of EU public interest entities:

- inform the directors of the PIE about the outcome of the statutory audit and explain its contribution to the integrity of the financial statements;
- monitor the financial reporting process;
- monitor the effectiveness of the internal quality control and risk management systems;
- monitor the process of the audit of statutory financial statements, mainly covering the findings and conclusions;
- oversee the statutory auditor's compliance with additional reporting requirements in the audit report and the report to the audit committee;
- pre-approve permissible non-audit services ("NAS") following an assessment of the threats to independence and the safeguards that the statutory auditor will apply to mitigate or eliminate those threats;
- being responsible for the procedure for the selection of the statutory auditor or audit firm.

8

Other aspects

8.1 Green and Sustainable Securitisation

To make the EU climate-neutral by 2050, Europe needs between EUR 175 billion to EUR 290 billion in additional yearly investment in the next decades. However, the European economy is largely bank-financed and the banks alone will not be able to provide the necessary funding. Therefore, the banks will need greater support from the capital markets in order to finance the transition (particularly post implementation of Basel III reforms – banks will be challenged by regulatory capital requirements).

Green securitisation can help address this financing challenge. In addition, securitisation may play an important role in financing environmental, social and governance ("ESG") investments. Such sustainable securitisation transactions apply minimum environmental or social standards with regards to the collateral, the use of proceeds or the originator / sponsor.

The potential advantages of green securitisation are numerous:

- There are a broad range of green assets / exposures that could be securitised – residential and commercial mortgages, car loans and leases, renewable energy project finance, SME loans etc.;
- Securitisation allows the aggregation of small, illiquid exposures into liquid, tradable securities or other financial instruments;
- Unlike conventional green bonds, securitisation allows tranching of risks / returns to the needs of a wider universe of potential investors;
- Securitisation eases banks' capital needs and sectoral concentration risks; and
- It can offer the long tenors needed for pension and insurance companies with long-dated liabilities.

Compared with the USA or China, however, European green securitisation has to date played a limited role in mobilising finance for sustainable investments. By end of Q1 2021, cumulative European green securitisation issuance had totalled less than EUR 10 billion (see Figure 36) compared with USD 116 billion (EUR 108 billion) in the USA and RMB 115 billion (EUR 15 billion) in China[1].

This has been in stark contrast to the success of green and other forms of ESG bonds in Europe. In fact, between 2019-2022 green securitisation issuance accounted for only 1.4% of ESG bond issuance in Europe vs. 32% in the USA and 8% in China[2].

One reason may be the stronger policy support for securitisation in general, and green securitisation in particular, in other regions. For example, green securitisation is strongly supported in China and in the USA, where there are major issuance programmes by Freddie Mac and Fannie Mae. In contrast, securitisation in Europe has not recovered to the same extent since the financial crisis.

Another reason may be the lack of specific standards for green securitisation, which has been a deterrent particularly for some European investors and issuers, given the tighter regulations and greater perceived reputational risks in Europe around ESG disclosures.

However, as mentioned above, sustainable securitisation could have a key role in (i) improving funding access to sustainable projects, (ii) increasing the ability to originate sustainable loans, (iii) expanding the pool of investors in sustainable projects, (iv) limiting sector exposures to the green industry and (v) helping investors' liabilities to match with tenors' assets.

A study on ESG Transformation of the Fixed Income Market by PwC Luxembourg and Strategy& Luxembourg suggests strong further potential for growth - 88% of investors that we surveyed were planning to increase their allocations

[1] EBA Report on developing a framework for sustainable securitisation dated 2 March 2022 available on *https://www.eba.europa.eu/eba-recommends-adjustments-proposed-eu-green-bond-standard-regards-securitisation-transactions*
[2] AFME European Green SecuritisationRegulatory State of Play dated December 2022 available on *https://www.afme.eu/Portals/0/DispatchFeaturedImages/221206%20AFME%20report%20ESG%20securitisation.pdf*

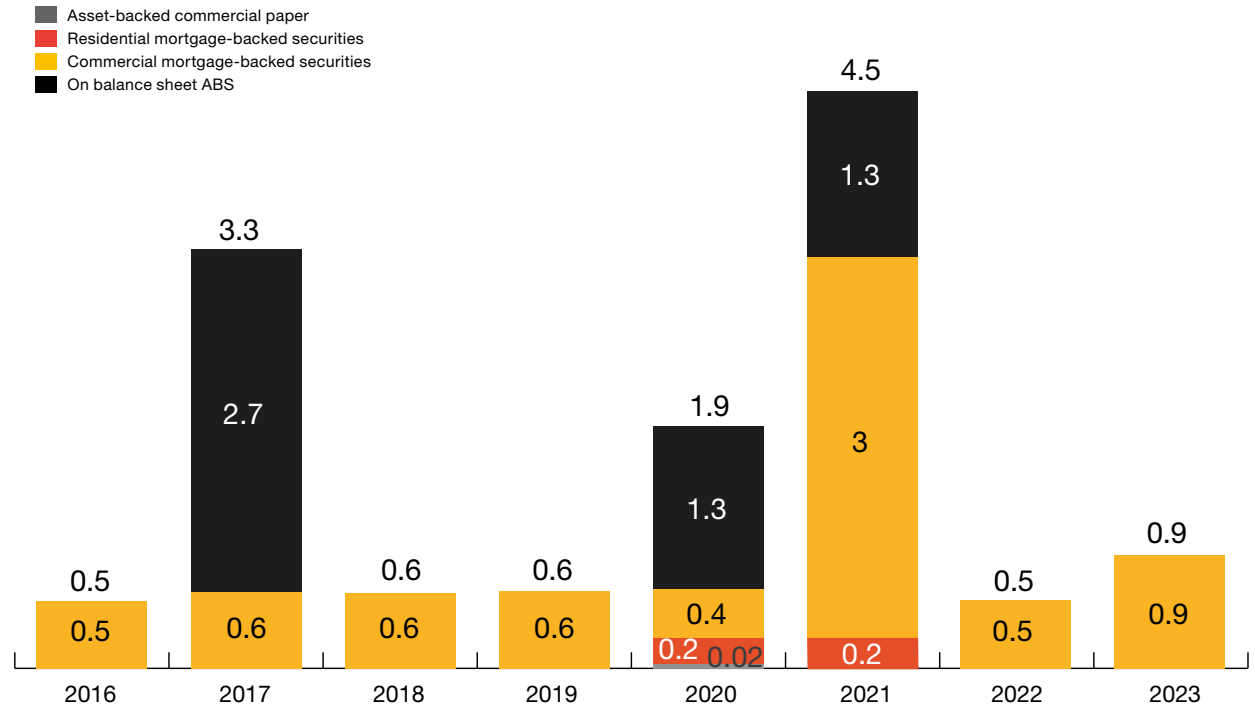
towards GSS bonds or green securitised products in the next 24 months - with three out of four investors targeting allocation increases of over 5%.

Two other developments around standards may also provide positive impetus to the market.

First, in July 2022, the International Capital Market Association (ICMA) provided new guidance on green securitisation and other secured structures in an appendix to its Green Bond Principles, a move that may help to foster growth through greater standardisation.

Second, the European Commission is expected to shortly publish a new draft of its regulatory proposal for a new EU Green Bond Standard (EUGBS), which shall incorporate recommendations by the EBA to use the EUGBS as a basis for sustainable securitisation, as opposed to the development of a new dedicated sustainable securitisation framework. The EBA also proposed certain adjustments to the EUGBS to make it easier to apply the standard to securitisation transactions. Specifically, and reflecting the limited current availability of assets in existing bank portfolios aligned with the EU sustainable finance taxonomy, the EBA recommended a change in the draft proposal to put the emphasis on the sustainability of the "use of proceeds" by originator / sponsor, rather than the sustainability of the collateral used by the issuing securitisation vehicle.

Figure 36 : European green securitisation issuance by asset class (EUR billion)



Source: AFME - ESG Finance ReportQ1 2023

EU Securitisation Regulation

The EU Securitisation Regulation currently only imposes a limited obligation to publish sustainability information. Indeed, for STS securitisations, the sell-side party must publish available information relating to the environmental performance of assets financed by residential real estate loans or car loans or leases. The modifications added to the Regulation in order to support the CMU after the Covid-19 crisis, entitled the originator to publish instead available information on major adverse impacts on sustainability factors of assets funded by the underlying exposures.

The publication of information according to sustainability would add a supplemental value to investors who could de facto measure their own share of investment in environmental, social and governance ("ESG") matters, in order to inter alia assess ESG risks.

With regards to the report published on 2 March 2022 by the EBA analysing the recent developments and challenges of introducing sustainability in the EU securitisation market, the EBA emphasises the fact that the EU sustainable securitisation market is still at an early stage of development. Furthermore, the application of sustainability requirements in securitisation appears to require further clarification[1].

The Commission agrees with the EBA's view that, at least in the short to medium term, there is no need to create a specific sustainability label for securitisations, particularly given the insufficient volume of sustainable assets available to date for securitisation and the lack of proper standards and definitions.

Accordingly, the Commission invites the European Parliament and the Council to take the EBA recommendation (the "EBA Recommendation") into consideration in the context of the ongoing negotiations on the European standards for green bonds ("EUGBS")[2] and stands ready to contribute to the work defining securitisation more precisely in the context of these EUGBS[3].

EU Green Bond Standard

The EUGBS (still under negotiation), aim to establish a framework for green bonds, including those issued by a securitisation entity in the context of securitisation transactions. To obtain the EUGBS label, the issuer must commit to using the proceeds resulting from issuance to finance, refinance or acquire assets aligned with the EU taxonomy.

According to the EUGBS, the EUGBS label can be used by the issuer for green bonds if the following conditions are met, namely:

(i) use 100% of its proceeds to finance EU taxonomy-compliant investments by the time the bond matures,

(ii) comply with the EUGBS disclosures frameworks; and

(iii) be verified by an external reviewer, which is registered with and supervised by the ESMA.

In its current wording, the EUGBS do not make a clear distinction between securitisations and securities not issued by a securitisation entity. In consequence, the EUGBS apply to "standard issuers" and securitisation issuers ("SSPE"). Moreover, the originator would still have the possibility, as the ultimate beneficiary of the proceeds of the issued bonds, to use them for non-sustainable projects. This situation becomes incompatible with the essence of the taxonomy and would limit the potential of a securitisation market compliant with the EUGBS since only SSPEs would have to respect and legally assume the EUGBS[4].

The EBA Recommendation consists in the fact that the EUGBS should apply to the originator of the securitisation and not to the SSPE in order to allow an equal treatment between securitisation transactions and other types of asset-backed securities as well as to ensure that the originator commits

[1] EBA Report on developing a framework for sustainable securitisation dated 2 March 2022 available on *https://www.eba.europa.eu/eba-recommends-adjustments-proposed-eu-green-bond-standard-regards-securitisation-transactions*
[2] Proposal for a regulation of the European parliament and of the council on European green bonds dated 6 July 2021 and available on *https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021PC0391*
[3] European Commission, Report from the Commission to the European Parliament and the Council on the Functioning of the Securitisation Regulation dated 10 October 2022 available on *https://eur-lex.europa.eu/legal-content/FR/TXT/?uri=CELEX:52022DC0517*
[4] EBA Report on developing a framework for sustainable securitisation dated 2 March 2022, point 3.4 and following.

to use all the proceeds of the EU green bonds-compliant securitisation to finance green assets as required by the European taxonomy[1].

In addition, the EBA Recommendation requires that additional transparency measures should be put in place in order to inform investors about the profile of the assets in which they invest. Likewise, the implementation of sustainability-related disclosures is essential to the good development of an EU green securitisation market.

Regarding the above, the EUGBS proposal can probably be modified in the forthcoming. Indeed, discussions relating to the EUGBS are still ongoing and the impact that its entry into force will have on securitisation transactions is yet to be determined and will largely depend on how the above recommendations will be reflected. The implementation of the EUGBS could be seen as an intermediate step before establishing a specific "green" regulation for securitisation nevertheless allowing the markets to develop towards a greener European economy. The tone is set, sustainability remains a hot topic that will continue to be at the heart of new regulatory concerns as well as for market participants.

Sustainable Finance Disclosure Regulation (SFDR)

The Sustainable Finance Disclosure (SFDR) regulation aims to reduce information asymmetries in principal-agent relationships with regard to the integration of sustainability risks, the consideration of adverse sustainability impacts, the promotion of environmental or social characteristics, and sustainable investment, by requiring financial market participants and financial advisers to make precontractual and ongoing disclosures to end investors when they act as agents of those end investors (principals).

In order to comply with their duties under those rules, financial market participants and financial advisers should integrate in their processes, including in their due diligence processes, and should assess on a continuous basis not only all relevant financial risks but also including all relevant sustainability risks that might have a relevant material negative impact on the financial return of an investment or advice.

To enhance transparency and inform end investors, access to information on how relevant sustainability risks are integrated, whether material or likely to be material, in the investment decision making processes, including the organisational, risk management and governance aspects of such processes, and in the advisory processes, respectively, should be regulated by the requirement to maintain concise information about the policies on their websites.

Securitisation vehicles and securitisation exposures do not directly fall within the scope of SFDR, there may be the requirement of a so-called "ESG" reporting which provides data that are required by investors to comply with their SFDR requirements.

[1] EBA Report on developing a framework for sustainable securitisation dated 2 March 2022, point 6.1: the sustainability-related disclosures for into the Regulation shall be drawing upon SFRD regulation as SFRD already lays down sustainability disclosure obligations for financial market participants and financial advisors vis-à-vis end-investors.

Outlook

The growing policy support – and investor demand – for green securitisation represents a significant opportunity for Luxembourg and its securitisation market:

- Luxembourg is a leading centre for securitisation and structured finance vehicles, with the Luxembourg Stock Exchange and Green Exchange as pioneers in MBS and green bonds in Europe;
- The flexibility and security offered by the Luxembourg Securitisation Law ensures innovation and legal certainty - Luxembourg already offers a very wide definition of assets and risks that can be securitised;
- EU Securitisation Regulation and STS framework are successful and increasingly used for large investment projects and fully compliant with Luxembourg (Securitisation) Law; and
- There is a strong outlook for Luxembourg's securitisation industry, in face of the CMU and European securitisation market development.

At the same time, the financial services sector needs to work closely together to seize the opportunity. For example, Luxembourg-based green labelling and eligibility criteria for green securitisation could be developed to complement the EU Securitisation Regulation even in advance of – and to complement – the finalisation of the EU Green Bond Standard.

There is also room for promoting the development of green mortgage-based securitisations out of Luxembourg. The EU Taxonomy, the EU Securitisation Regulation and the Energy Efficient Mortgage Action Plan create the opportunity of a standardised "green mortgage" across the EU. Luxembourg should continue to actively market its issuance and trading platforms to European investors in this regard.

8.2 Blockchain and securitisation

The use of blockchain and distributed ledger technology in financial markets has drawn increasing attention over the past years. While the evolution of blockchain along with smart contracts for capital markets and tokenisation may still be at an early stage, it promises that securitisation is one of the areas in capital markets that could benefit most from the transformation.

Blockchain together with smart contracts have the potential to dramatically change the role of the parties involved in securitisation transactions, from the originator up to the investor including regulators and auditors. It can also bring significant advantages through streamlined processes, lower costs, increased transaction speed, enhanced transparency and improved security.

Blockchain basics

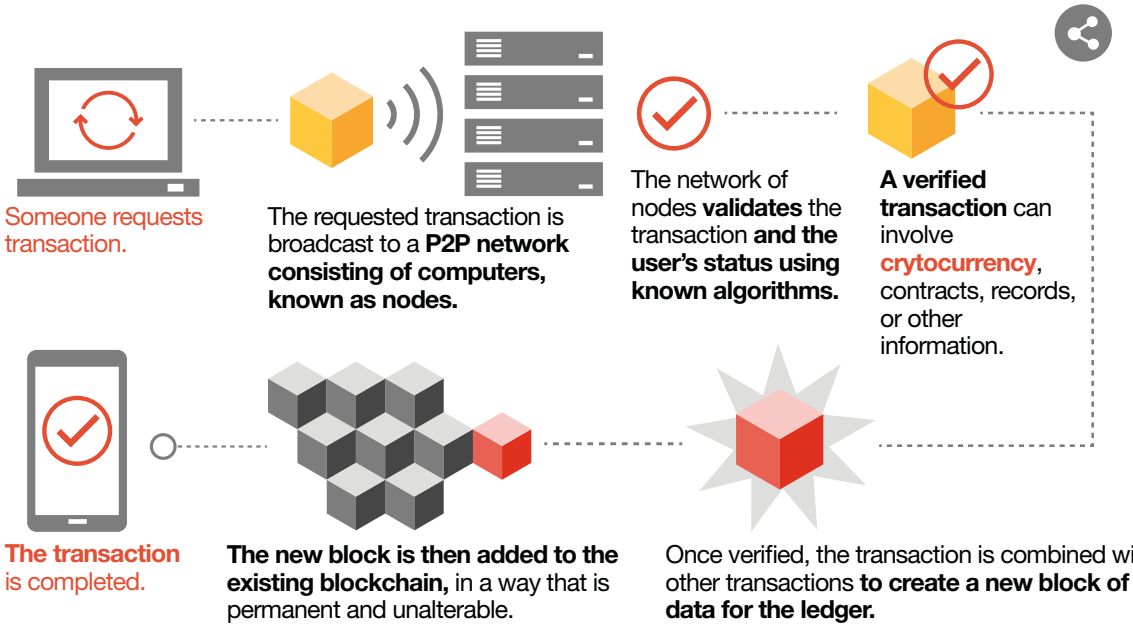
In simple terms and generically speaking, blockchain is a type of distributed ledger technology ("DLT") that allows simultaneous access, validation, and records updates of transactions across a network of participants. Please refer to Figure 37 for an illustrative example of a blockchain transaction.

Transactions within a blockchain context can take different forms, the most obvious one being financial transaction/transfer of value. By using smart contracts, other transactions, like waterfall calculation or redemptions, can also be embedded within the blockchain.

It is important to note that there is not only one type of blockchain but rather a diversity of blockchains which entail a set of common features as well as key design differences, including level of decentralisation, privacy or degree of permissioning for example. The common features are:

- **Trustless network of participants (nodes):** No matter the type of blockchain, each underlying network is composed of participants called nodes, i.e. computers/hardwares, which allow transactions to be sent and validated. These participants do not need to trust each other to engage in transactions, as the blockchain itself guarantees trust.
- **Decentralisation:** Blockchain protocols are decentralised and not controlled by any central authority. This removes the risk inherent to a single point of failure and makes the network more resilient than a centralised infrastructure.
- **Records transparency and immutability:** Every participant in the network has simultaneous access to a view of the information and transaction history, providing for a single version of the truth and removing reconciliation frictions. Furthermore, information in a blockchain is securely stored by cryptographic functions and cannot be modified by any party ex-post, significantly reducing the risk of data manipulation or forging.
- **Consensus mechanism:** Transaction verification and validation is achieved by participants confirming updates with one another, replacing the need for a third party to authorise and validate transactions. Consensus mechanisms are the cornerstone of any blockchain, they allow for a trustless environment and can be of many different types. The most well-known are Proof-of-Work ("PoW"), Proof-of-Stake ("PoS") and Proof-of-Authority ("PoA"). While a complete description of each of them is beyond the scope of this publication, each has its own specificities that directly impact scalability, security, energy consumption and the degree of decentralisation attached to them.
- **Smart contract integration:** Smart contracts are programmable business logic that enables the automation of contract execution between multiple parties.
- **Access to the network and data ledger:** The degree of privacy depends on the authorised level of anonymity of network participants and the actions that they are allowed to perform within that network. In permissionless and public networks, which are used for example in Bitcoin, anyone can download the protocol and validate the transactions. In permissioned and private networks only certain validated notes can be part of the network and validate transactions.

Figure 37: Illustrative example of a blockchain transaction



It would be a wrong shortcut to consider one type of blockchain as de facto superior to another one in absolute terms, indeed certain types of blockchains will make more sense depending on the effective use cases and specific needs or requirements of its users group.

Nevertheless, we observe that smart contracts enabled public blockchains like Ethereum or Solana and private ones like Quorum, Hyperlegder and Corda to capture a significant part of the market initiatives at the time of writing.

Smart contracts basics

Smart contracts are programmable business logic (codes) that enable the automation of contract execution between multiple parties on a blockchain infrastructure. In simple terms, smart contracts autonomously trigger the execution of a defined action upon the occurrence of a predefined event (e.g. interest payments or waterfall computation). They are automated rule-based agreements that require limited, to no, human interaction.

The code checks if a predefined condition has been fulfilled and subsequently executes the embedded logic. More precisely a smart contract is activated by a node as soon as this node validates a transaction wishing to interact with it.

Enabling this concept within a blockchain context greatly reduces the dependency on third-party validation and can automate a vast scope of functions and, therefore, leading to significant process efficiencies and cost savings.

Smart contracts are self-governing and will react automatically to external triggers. A change in the data state is only possible if there is a network consensus for the change. As each node has a replicated and in-sync copy of the contracts, they cannot be deleted. The fact that smart contracts can replace tasks which are currently performed manually (e.g. reconciliations), leads to enhanced efficiency and the elimination of human error.

Smart contracts also bear some risks. As self-executing and autonomous, smart contracts can create significant damages if they present security or functional loopholes. Given the irreversibility of transactions within a blockchain context, it is of utmost importance to ensure the highest level of security and functional testing before they are deployed across the network.

Tokenisation and security tokens

Tokenisation is the process of issuing or converting an asset into a digital form - a token - that is stored on, and transferred over, a blockchain-based infrastructure. The major types of tokens include utility tokens, security tokens and payment tokens.

The case of security tokens is of particular interest in a securitisation context. Security tokens refer to financial instrument-backed tokens which therefore combine the technological advancements provided by blockchain and smart contracts with an established regulatory framework since they are expected to fall under existing securities laws and financial instruments regulations.

Tokenisation brings many tangible benefits, some of them include:

- Fractional ownership and enhanced investability;
- Transferability 24/7;
- Shorter settlement time;
- Improved efficiency through programmability features (investors eligibility, restrictions, compliance, etc.).

But tokenisation still faces numerous challenges, among others:

- Knowledge gap and misconceptions;
- Investors and market readiness;
- Development of DLT market infrastructures;
- Token protocols standardisation.

How can blockchain improve the securitisation lifecycle?

Even though constant improvements of efficiency could be ascertained over the last years in the securitisation lifecycle, there still exists a significant amount of error-prone manual interventions, inefficiencies, and opacity from origination up to the trading of the securities issued.

Origination process

The asset related data within the origination process such as contractual terms, borrower credit profiles and collateral information are rarely standardised between the different parties involved in the process (e.g. originator, asset servicer, trustee, investors, rating agencies) and still include a considerable amount

of paperwork. Even the digital champions under the originators are obliged to keep some documents on paper, such as deeds and appraisals. Moreover, the involved parties usually store the same type of data in different formats in each of their own data warehouses. While this provides extra security, it also comes with a lot of manual input in the reconciliation processes, giving rise to potential inconsistencies among the parties and leading to inefficiencies, time lags and additional costs in the entire process which reduces the market efficiency.

While blockchain will not directly impact the standardisation of underlying asset data, it can serve as a distributed infrastructure within which each stakeholder can contribute data according to a predefined framework and ensure consistency, availability and safety of the data. Doing so will create a single version of the truth available to all participants and significantly reduce the risk of inconsistency as well as the need for reconciliations. As a result, risk or errors are reduced, processing times are improved and workflows between the different parties involved are made more efficient.

Structuring of the security

Setting up a Special Purpose Vehicle ("SPV") and structuring the security is considered to be a complex exercise, but there is a lot of duplicating work. While all the different parties use the same offering documents of an SPV, servicers, investors, accountants, trustees, and any other party involved, use their own independent systems to calculate the waterfall of payments for the same securitisation structure and may arrive at different results due to the different interpretation of the terms of transaction.

The distributed environment provided by blockchain significantly improves the traditional siloed and sequenced context under which transactions are taking place. The way information is stored, available and secured increases data consistency, and consensus mechanisms amongst network participants can reduce the risk of different interpretations.

Another focus lies on the risk of fraud. Investing in assets that may not exist, or assets which were double pledged, can lead to serious financial losses for the investors. Investing in trade receivables, for example, gives rise to an increased risk regarding the existence of the asset.

Mitigation of this risk comes with an increased cost, under the form of lengthy and costly due diligence.

Taking advantage of the blockchain technology and the tokenisation of the SPV will help to drastically reduce this risk of fraud. Indeed, any person will be able to view the assets on the blockchain as well as the owner address. Moreover, it is not possible to have two owners for the same asset (we do not consider multi-signature wallets here). The tokenisation of underlying assets could provide full transparency over assets' underlying data and more importantly could reduce the risk of fraud by ensuring assets' existence and pinpointing any pledge already in place, solving double pledging issues. The transparency added by this type of technology combined with a diligent data audit will bring further trust to the securitisation market.

Servicing and trading the security

After the transaction is concluded and the security hits the primary market, the participants involved incur a multitude of costs (research, due diligence) in order to gather reliable information about it. Usually, due to time lags, investors and rating agencies have to make decisions without having the full picture, while the asset servicer can provide accurate information only after the final payments are made to investors.

While these costs and delays may be considered small for individual entities, they are important for the securitisation market in aggregate. Also, in the current market conditions the cost of these inefficiencies are hidden by the low default rates in most of the asset classes. But in times of a deterioration of

the financial markets, the timely and accurate monitoring of assets becomes even more important, as information delays for investors contribute to a wider loss of confidence in the asset quality. The review of the currently existing heterogeneous asset related data which is stored in multiple locations comes with high costs especially for the asset servicers, but also other parties involved.

Tokenisation of the security could greatly improve the transparency of underlying data (from assets' origination to security issuance) and create a data rich environment where the token holder could have access to all underlying security data made available at any time. This would reduce information asymmetry and would therefore improve market efficiency.

Furthermore, smart contract integration could allow for builtin compliance, ensuring that investors' eligibility and/or any defined security rules are enforced autonomously at token level.

Secondary market trading

The problems with the secondary market are mainly related to the liquidity constraints and the different level of information between the investors. Compared with the primary market, where all the players have the same level of information regarding the asset classes in which they want to invest, on the secondary markets, the big players with closer relationships to brokers/dealers may get information faster and more accurately. Whilst this would represent an advantage for them, for the market as a whole this is negative, due to the limitation on the number of investors. The limited access to data or delays in accessing the information about the underlying asset, may raise questions about the quality of the asset, for all the investors.

Similarly to primary issuance, blockchain has the potential to improve data transparency and to provide for programmability features (including any post issuance security event - i.e. corporate actions, lock-up period or trading restrictions and specific rules).

In addition, security tokenisation would provide for the digitisation of the shareholder/noteholder register (i.e. any transactions would be automatically reflected in the register, ensuring continuously up-to-date ownership data) as well as enhanced transferability of the security. While only peer-to-peer transfers are available today for security tokens, the upcoming Pilot Regime Regulation will provide the regulatory framework for the development of DLT market infrastructures, opening up the perspectives for active/ organised secondary markets for security tokens in Europe.

Remaining challenges

Despite the growing maturity of blockchain linked topics and their widespread adoption, market participants are still facing several challenges in the field.

Education & skills

Blockchain, smart contracts, tokenisation, these are conceptual topics which might be perceived as above-average in terms of complexity. As a consequence, many participants are staying outside the conversation and running the risk of being disrupted.

Technological risks

As mentioned previously, the blockchain landscape is very broad, token protocols standardisation is a work in progress and smart contract security and functional design are of critical importance. All of this suggests important technological risks which must be properly assessed, understood and mitigated.

Interoperability

Interoperability refers to the potential for different blockchains and underlying protocols to interact with each other. As of today, this interoperability is quite limited and the choice of a blockchain is therefore critical and strategic as it can either ensure a maximum of flexibility or lock you in.

Legal and regulatory developments

While regulatory clarity has improved overall lately, and technological neutrality is more often than not a key design principle of new laws and regulations, the regulatory framework around DLT and security tokens is still a work in progress. Developments at MiFID level - to recognise tokenised financial instruments - or the Pilot Regime Regulation - aiming at supporting the developments of DLT market infrastructures, hence opening the door for organised and regulated markets for security tokens, will be instrumental in supporting market participants in their ventures. It will be particularly important to closely monitor the progress of the legislative processes and

to ensure a clear understanding of the ins and outs of these upcoming texts as well as their equivalent across the globe.

Luxembourg's legal framework

After the introduction of the Blockchain I Law in 2019 recognising blockchain as equal to traditional transactions and allowing the use of DLTs for account registration, transfer of securities, and their materialisation, Luxembourg took a further step in 2021 towards the innovation in financial services with the adaptation of the Law of 22 January 2021 (Blockchain II Law) by the Luxembourg Parliament, modifying the Law of 5 April 1993 on the financial sector and the Law of 6 April 2013 on dematerialised securities.

The Blockchain II Law, recognised the ability to use new secured electronic registration systems, such as DLT or distributed electronic databases in the context of issuances of listed and unlisted dematerialized securities by legally clarifying the notion of account registration in order to ensure issuances and the circulation of dematerialized securities within the DLT environment.

The Blockchain II Law further extended the scope of entities able to act as central account keepers to EU credit institutions and investment firms if the latter meets the technical and organisational requirements to operate such activities.

With the introduction of the Blockchain III Law which entered into force on 23 March 2023, Luxembourg completed its legal framework around distributed ledger technology. The third law implements the EU Regulation 2022/858 on a pilot regime for market infrastructures based on distributed ledger technology and introduces changes to the existing Law of 5 April 1993 on the financial sector, the Law of 5 August 2005 on financial collateral arrangements and the Law of 30 May 2008 on markets in financial instruments.

The regulation entitles national competent authorities to temporarily exempt market infrastructures intending to use DLT from some specific requirements typically applicable to traditional market infrastructures as set out by the existing legislation.

The main features of the new law are on the one hand the clarification on the definition of financial instruments, extending the the notion of financial instruments also to those instruments issued and represented under the DLT and confirming that financial instruments booked in securities accounts held on DLT qualify as financial instruments within the meaning of the Law of 5 August 2005 on financial collateral arrangements.

Through the continuous evolution of its legal framework, the Luxembourg legislator legally recognizes the existence of DLT in the financial sector and adopts a dynamic approach attracting financial players using DLT in order to improve competitiveness while providing legal certainty in this constantly evolving environment.

Outlook

Despite the before mentioned potential benefits blockchain technology could provide within the securitisation lifecycle, there are also still challenges to overcome. However, the rising interest and awareness of that topic leads to progressive usage of various elements of the blockchain technology from market participants. Most likely the adoption of blockchain in securitisation will be progressively, first concentrating on the digitalisation of certain aspects in the transactions before the entire lifecycle will be moved "on chain".

Therefore, it can be assumed that usage of blockchain technology will first co-exist together with the established processes currently in place. However, the technology has the potential to dramatically transform the entire securitisation lifecycle over time.

	Securitisation vehicle	UCI Part II	SIF	SICAR	RAIF
Background	Highly flexible, mainly unregulated multipurpose investment vehicle transforming assets or risks into financial instruments Governed by the Law of 22 March 2004 ("Securitisation Law")	The classic regulated alternative investment fund publicly distributed in Luxembourg Governed by «Part II» of the Law of 17 December 2010 ("Fund Law")	Regulated and flexible multipurpose investment fund regime for institutional investors Governed by the Law of 13 February 2007 ("SIF Law"), which is split in two sections (general provisions and those applicable to AIFs only)	Private and venture capital investment vehicle exclusively dedicated to investments in risk capital Governed by the Law of 15 June 2004 ("SICAR Law"), which is split in two sections (general provisions and those applicable to AIFs only)	Very flexible, multipurpose alternative investment fund without (direct) supervision by the CSSF on product level Governed by the Law of 23 July 2016 ("RAIF Law"), oriented at SIF and SICAR regimes
Legal form	Securitisation Company, in the form of SA, Sarl, SCA, SCoopSA, SNC, SCS, SCSp and SAS Securitisation Fund, in the form of co-ownerships or fiduciary estate, managed by an unregulated management company Segregated sub-funds/ compartments possible	Fonds Commun de Placement (FCP) Société d'Investissement à Capital Variable (SICAV), in the form of a SA Société d'Investissement à Capital Fixe (SICAF), in the form of SA, Sarl, SCA, SCS or SCSp Segregated sub-funds/ compartments possible	FCP SICAV/SICAF, in the form of SA, Sarl, SCA, SCS, SCSp or SCoopSA Segregated sub-funds/ compartments possible	Partnership (SCS or SCSp) or corporation (SA, Sarl, SCA or SCoopSA) Segregated sub-funds/ compartments possible	FCP SICAV/SICAF, in the form of SA, Sarl, SCA, SCS, SCSp or SCoopSA Segregated sub-funds/ compartments possible
Minimum capital requirements	Securitisation Company: depending on legal form (e.g. SA: EUR 30k, Sarl: EUR 12k, Partnerships: none) Securitisation Fund: none (but for management company depending on legal form)	EUR 1.25 million to be reached within six months of authorisation	EUR 1.25 million to be reached within twelve months of authorisation	EUR 1.0 million to be reached within twelve months of authorisation	EUR 1.25 million to be reached within twelve months after set-up
Supervision	No supervision by CSSF (except if continuously issuing to the public) Luxembourg Securitisation Vehicles do normally not qualify as AIF (see CSSF FAQ)	Supervised by the CSSF Qualify as AIF as per Law of 12 July 2013 ("AIFM Law") and require an authorised Alternative Investment Fund Manager (AIFM)	Supervised by the CSSF Most SIFs qualify as AIF and require an authorised AIFM	Supervised by the CSSF Some SICARs qualify as AIFs and require an authorised AIFM	RAIF itself not supervised by CSSF but has to be managed by an authorised AIFM All RAIF qualify as AIFs and require an external authorised AIFM
Investment restrictions	No restriction of eligible investments (but no entrepreneurial activity) No risk diversification requirement No restriction of investor types (but CSSF supervision if continuously issuing to the public)	No restriction of eligible investments (but prior approval of investment objective and strategy by CSSF) Some risk diversification required (max. 20% of NAV per investment) No restriction of investor types	No restriction of eligible investments Some risk diversification required (max. 30% of NAV per investment) Well-informed investors only, i.e. institutional, professional investors or high net-worth individuals	Investments restricted to risk capital only No risk diversification requirement Well-informed investors only	No restriction of eligible investments Some risk diversification required similar to SIF, except if exclusively invested in risk capital (no diversification required) Well-informed investors only

	Securitisation vehicle	UCI Part II	SIF	SICAR	RAIF
Valuation of assets (LuxGAAP)	Securitisation Company: at (i) cost less impairment, (ii) lower of cost or market, or (iii) fair value option Securitisation Fund: at realisable value estimated in good faith (if not provided for differently in management regulations/ constitutive documents)	At realisable value estimated in good faith (if not provided for differently in management regulations/constitutive documents)	At fair value (if not provided for differently in management regulations/constitutive documents)	At fair value (to be determined according to rules in constitutive documents)	At fair value (if not provided for differently in management regulations/ constitutive documents)
Tax status	Securitisation Companies: fully taxable while exempt from net wealth tax (except for minimum net wealth tax). In addition, distributions to investors/creditors are fully tax deductible, i.e. reducing the tax base Securitisation Fund: tax-exempt from direct taxes (income and net wealth tax) Neither Securitisation Company nor Securitisation Fund subject to subscription tax Subject to VAT but exemption on management services	Tax-exempt from direct taxes (income and net wealth tax) Subscription tax (taxe d'abonnement) of 0.01% or 0.05% of NAV p.a. Subject to VAT but exemption on management services	Tax-exempt from direct taxes (income and net wealth tax) Subscription tax of 0.01% of NAV p.a. Subject to VAT but exemption on management services	Partnerships are Luxembourg tax transparent, i.e. no taxation at the level of the Luxembourg partnership Corporate legal forms are in general fully taxable while exempt from net wealth tax (except for minimum net wealth tax). In addition, tax exemption for income (including interest) from investments in risk bearing capital. All other income is subject to income tax Not subject to subscription tax Subject to VAT but exemption on management services	Tax-exempt from direct taxes (income and net wealth tax) like a SIF as long as not invested exclusively in risk capital. In that case, taxation like SICAR and subject to the minimum net wealth tax Subscription tax of 0.01% of NAV p.a.; exempt if taxed like SICAR Subject to VAT but exemption on management services
Treaty status	Securitisation Company: may have access to several Luxembourg DTT Securitisation Fund: generally have no access to DTT	FCP generally have no access to DTT SICAVs and SICAFs may have access to several Luxembourg DTT	FCP generally have no access to DTT SICAVs and SICAFs may have access to several Luxembourg DTT	Partnerships generally have no access to DTT SICARs in corporate form may have access to several Luxembourg DTT	RAIFs under SICAR tax regime and in corporate form may have access to several Luxembourg DTT FCP and partnerships generally have no access to DTT SICAVs and SICAFs (non-SICAR regime) may have access to several Luxembourg DTT
Withholding tax	Distributions from an SV are not subject to Luxembourg WHT	Distributions from a UCI Part II are not subject to Luxembourg WHT	Distributions from a SIF are not subject to Luxembourg WHT	Distributions from a SICAR are not subject to Luxembourg WHT	Distributions from a RAIF are not subject to Luxembourg WHT

9 Glossary

In addition to the glossary of securitisation terms hereunder, the following table provides an overview of the most relevant laws and regulations referred to in this brochure.

Luxembourg Laws

Accounting Law	Law of 19 December 2002 on the trade and companies register and the accounting and the annual accounts of companies
AIFM Law	Law of 12 July 2013 on alternative investment fund managers
Audit Law	Law of 23 July 2016 concerning the audit profession
Commercial Law	Law of 10 August 1915 on commercial companies
DS Law	Law of 6 April 2013 on dematerialised securities
Fund Law	Law of 17 December 2010 on undertakings for collective investment
MDR Law	Law of 25 March 2020 on reportable cross-border arrangements (also referred to as DAC 6 Law)
Prospectus Law	Law of 16 July 2019 on prospectuses for securities
Securitisation Law	Law of 22 March 2004 on securitisation
Transparency Law	Law of 11 January 2008 on transparency requirements for issuers
Blockchain I Law	Law of 1 March 2019 amending the law of 1 August 2001 on the circulation of securities
Blockchain II Law	Law of 22 January 2021 amending the modified law of 5 April 1993 on the financial sector and 6 April 2013 on dematerialised securities
Blockchain III Law	Law of 15 March 2023 implementing the EU Regulation 2022/858 on a pilot regime for market infrastructures based on distributed ledger technology

EU Regulations and Directives

EU Securitisation Regulation	Regulation (EU) No 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012
European green bond standard (EUGBS)	Proposal 2021/0191(COD) for a Regulation of the European Parliament and of the Council of 6 July 2021 on European green bonds [Provisional agreement on final text was reached on 28 February 2023]
Capital Requirements Regulation (CRR)	Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012
Sustainable Finance Disclosure Regulation (SFDR)	Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector
Solvency II Directive	Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II)
EU Audit Legislation	Directive 2014/56/EU and Regulation (EU) No 537/2014
Anti-Tax Avoidance Directives (ATAD)	Directive 2016/1164 of 12 July 2016 («ATAD 1»), Directive 2017/952 of 29 May 2017 («ATAD 2») and draft Directive 2021/0434 («ATAD 3»).
Prospectus Regulation	Regulation (EU) No 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC, as amended.
Commission Delegated Regulation	Commission Delegated Regulation (EU) 2019/979 of 14 March 2019 supplementing Regulation (EU) 2017/1129 of the European Parliament and of the Council with regard to regulatory technical standards on key financial information in the summary of a prospectus, the publication and classification of prospectuses, advertisements for securities, supplements to a prospectus, and the notification portal.
Pilot Regime for DLT	Regulation (EU) 2022/858 on a pilot regime for market infrastructures based on distributed ledger technology, and amending Regulations (EU) No 600/2014 and (EU) No 909/2014 and Directive 2014/65/EU
Arranger	The party (often an investment bank) that establishes the securitisation transaction. It brings together the investors and the pool of assets. The arranger evaluates the assets, determines the characteristics of the securities to be issued, assesses the need for specific structuring and arranges for distribution of the securities to the investors.
Asset-Backed Commercial Paper (ABCP)	Transactions, where normally short-term receivables (e.g. trade receivables) are pooled into a SV. The SV in turn issues Commercial Papers (normally with 90 to 270 days remaining until maturity), which are called Asset-Backed Commercial Papers. The SV may be established for a single seller of short-term receivables or for a pool of sellers (multi-seller ABCP conduit).
Asset-Backed Securities (ABS)	Securities generally issued by a SV, which are backed by assets rather than by a payment obligation.
Backup servicer	Normally, the originator of a securitisation transaction continues to service the original transaction. In pre-agreed circumstances the SV can, however, obtain the authority to bring in a backup servicer to replace the originator as servicer.
Bankruptcy-remote	The term applied to an entity that is not likely to have an incentive to commence insolvency proceedings voluntarily and that is not likely to have an involuntary insolvency proceeding commenced against it by third-party creditors.

Securitisation Terms

This Glossary does not only contain terms used in this brochure but is meant to be a compilation of terms generally used in the context of securitisation transactions. As such, you can use it as a general reference guide whenever you need a quick definition of a term.

Please note that the definitions used below may deviate from the ones used in regulatory texts like the EU Securitisation Regulation. For regulatory purposes the definitions of the Regulation shall prevail. Furthermore, when referring to "SV" in the definitions below, in the Luxembourg context this shall apply to each of the compartments of a SV.

Beneficial interest	In contrast to legal interest, beneficial interest means the right to stand to benefit, independent of the legal title. In a securitisation transaction, the receivables/cash flow or security interest thereon are legally held by the SV or trust, for the ultimate benefit of the investors; that means the investors are the ultimate beneficiaries and their interest is the ultimate beneficial interest.
Cash collateral	In a securitisation transaction, the originator may deposit some cash in the SV to enhance creditworthiness for the investors. The cash deposit is not normally used by the SV to acquire receivables from the originator.
Cash Collateral Account (CCA)	A reserve fund that provides credit support to a transaction. Funds in a CCA are lent to the issuer by a third party, typically a letter of credit from a bank, pursuant to a loan agreement.
Cash flow waterfall	The rules by which the cash flow available to an issuer, after covering all expenses, is allocated to the debt service owed to holders of the various classes of securities issued in connection with a transaction.
Clean up buyback or call	An option giving the originator the right to buy back the outstanding securitised assets when the principal outstanding has been substantially amortised. The option is usually exercised when the outstanding principal is less than 10% of the original principal.
Collateral	Is the underlying security, mortgage or asset for the purposes of securitisation or borrowing and lending activities. In respect of securitisation transactions, it means the underlying cash flow.
Collateral manager	The collateral manager manages the collateral that is purchased and sold by the SV regularly (used especially in arbitrage transactions).
Collateralised Bond Obligations (CBO)	Obligations, usually structured obligations, issued which are collateralised by a portfolio of bonds, transferred by an originator, or purchased from the market with the intention to securitise them.
Collateralised Debt Obligations (CDO)	A common name for Collateralised Bond Obligations and Collateralised Loan Obligations.
Collateralised Fund Obligations (CFO)	Obligations, usually structured obligations, issued which are collateralised by a portfolio of hedge funds or equity fund investments, transferred by an originator or purchased from the market with the intention to securitise them.
Collateralised Loan Obligations (CLO)	Obligations, usually structured obligations, issued which are collateralised by a portfolio of loans, transferred by an originator or purchased from the market with the intention to securitise them.
Collateralised Mortgage Obligations (CMO)	A securitisation transaction where the SV's cash inflows are divided into different tranches. The tranches, having different payback periods and priority profiles, repay the bonds issued by the SV in line with the predetermined payback periods and priority profiles of the bonds. On issue, the bonds are usually structured and served in accordance with investors' objectives and risk profiles.
Co-mingling risk	When the originator in a securitisation acts at the same time as the servicer, the cash flows collected by the originator may sometimes commingle, or may intentionally be mixed up with that of the originator him/herself. Thus, it is no longer possibly to clearly identify the cash flow collected on behalf of the SV. This is called co-mingling.
Commercial mortgage-backed securities (CMBS)	A part of Mortgage-Backed Securities. The expression is used to avoid confusion with the term Residential Mortgage-Backed Securities (RMBS). Commercial mortgages represent mortgage loans for commercial properties, such as multi-family dwelling, shops, restaurants, showrooms, etc.
Conduit	A securitisation vehicle that is normally used by third parties as a ready-to-use medium for securitisation, usually for assets with multiple originators. Conduits are mostly used in cases of Asset-Backed Commercial Paper, CMBS etc. There are two types, the single seller conduit and the multi-seller conduit.
Covenant	In terms of legal documents, a covenant is a promise to do or not to do something stipulated in the related agreement.
Credit Default Swap (CDS)	If there are predefined credit events that indicate credit default by a reference obligor, a credit derivative deal is executed, which means that either a specific obligation of the obligor will be swapped between the counterparties against cash or one party will pay compensation to the other.

Credit enhancement	General term for measures taken by the originator in a securitisation structure to enhance the securitised instrument's security, credit or rating. These measures include cash collateral, profit retention and third-party guarantees. Credit Enhancement devices can be differentiated as structural credit enhancement, originator credit enhancement and third-party credit enhancement.
Credit derivative	A derivative contract whereby one party tries to transfer the credit risk, or variation in returns on an asset, to another. Common types are credit default swaps, credit linked notes and synthetic assets.
Credit Linked Note (CLN)	A note or debt security which allows the issuer to set off the claims under an embedded credit derivative contract from the interest, principal or both, payable to the investor in such a note.
Credit enhancer	A party who agrees to elevate the credit quality of another party or a pool of assets by making payments, usually up to a specified amount, in the event that the other party defaults on their payment obligations or the cash flow produced by the pool of assets is less than the amount(s) contractually required because of defaults by the underlying obligors.
Default	A failure by one party to a contractual agreement to live up to their obligations under the agreement; a breach of a contractual agreement.
Deferred purchase price	A type of credit enhancement where a portion of the purchase price of the assets is reserved by the SV to serve as cash collateral.
Derecognition	The action of removing an asset or liability from the balance sheet. In securitisation transactions, the term refers to derecognition of assets securitised by the originator when they are sold for securitisation. Before derecognition is permitted, certain conditions, stated in the accounting standards, have to be fulfilled.
Eligibility criteria	The choice of receivables that the originator assigns to the SV. The eligibility criteria are usually stated in the receivables sale agreement with a provision that a breach of the criteria would amount to breach of warranties by the originator, obliging the originator to buy back the receivables.
European Single Electronic Format (ESEF)	With respect to the Law of 11 January 2008 ("Transparency Law") and Commission Delegated Regulation (EU) 2019/815 of 17 December 2018 supplementing Directive 2004/109/EC of the European Parliament and of the Council with regard to regulatory technical standards on the specification of a single electronic reporting format
Event risk	The risk that an issuer's ability to make debt-service payments will change because of dramatic unanticipated changes in the market environment, such as a natural disaster, an industrial accident, a major shift in regulation, a takeover or corporate restructuring.
Excess spread	The excess of the proceeds inherent in the SV's asset portfolio, over the interests payable to the investors and the expenses of the transaction.
Expected maturity	The time period within which the securities are expected to be fully paid back. However, the expected maturity is not the legal final maturity, as the transaction's rating is not based on repayment by the expected maturity.
Extension Risk	The possibility that prepayments will be slower than an anticipated rate, causing later-than-expected return of principal. This usually occurs during times of rising interest rates. Opposite of prepayment risk.
External credit enhancement	Credit support provided to a securitisation by a highly rated third party.
First-loss risk	When the risks in the SV's asset portfolio are segregated into several tranches, the first-loss risk, to a certain extent, is borne by a particular class before it can affect the other classes. The first-loss class must fully cover the loss before it affects the other classes. The first-loss class can be compared to the equity of an entity and provides credit enhancement to the other classes.
Future-flows securitisation	The securitisation of receivables which only arise in future periods.
Guaranteed investment contract	A contract in which a particular rate of return on investments is guaranteed.
Issuer	Within the framework of securitisations, the issuer is the SV which issues the securities to the investors.
Internal credit enhancement	Structural mechanism or mechanisms built into a securitisation to improve the credit quality of the senior classes of securities issued in connection with the transaction, usually based on channelling asset cash flow in ways that protect those securities from experiencing shortfalls.
Investment grade	With respect to Standard & Poor's ratings, a long-term credit rating of BBB- or higher. With respect to Moody's ratings, a long-term credit rating of Baa3 or higher.
Junior bonds	Bonds that rank below senior bonds. These bonds or tranches of securities issued by an SV suffer losses on the securitised assets first.

Legal final maturity	The final maturity by which a security must be repaid to avoid the contractual obligation defaulting. Typically, in securitisation transactions, the legal maturity is set at a few months after the expected maturity, to allow for delinquent assets to pay off and to avoid contractual default which can lead to the winding up of the transaction.
Letter of credit	An agreement between a bank and another party under which the bank agrees to make funds available to or upon the order of the other party upon receiving notification.
Limited recourse	The right of recourse (of investors and creditors) is limited to a particular amount or, in the context of a securitisation transaction, the right of recourse is limited to assets of SV (no recourse to originator or arranger).
Liquidity facility	A short-term liquidity or overdraft facility provided by a bank or the originator of the SV to meet the short-term funding gaps and pay off its securities. Liquidity facilities can sometimes be substantial and the only way to redeem securities – for example, in the case of ABCP conduits.
Liquidity provider	The provider of a facility that ensures a source of cash with which to make timely payments of interest and principal on securities if there is a temporary shortfall in the cash flow being generated by the underlying assets.
Mezzanine bonds	Bonds that rank in priority below senior bonds, but above junior bonds.
Mortgage-Backed Securities (MBS)	Securities backed by cash flow resulting from mortgage loans. MBSs can be divided into residential mortgage-backed securities and commercial mortgage-backed securities.
Non-petition clause	A legal provision meaning that investors and creditors may waive their rights to initiate a bankruptcy proceeding against the securitisation vehicle. This clause protects the vehicle against the actions of individual investors who may, for example, have an interest in a bankruptcy proceeding against the vehicle.
Obligor	The debtor from whom the originator has right to receivables.
Offering circular	A disclosure document used in marketing a new security's issuance to prospective investors.
Originator	The entity assigning assets in a securitisation transaction.
Originator advance	A liquidity facility provided by an originator to a securitisation transaction, whereby the originator pays the expected collections of one or more months by way of an advance and later appropriates the actual collections to reimburse them.
Originator credit enhancement	Credit enhancement granted by the originator, like cash collateral, over-collateralisation, etc.
Orphan company	A company without identifiable shareholders, e.g. an SV owned by a charitable trust or a "Stichting". Such a company is often used to avoid consolidating the SV with any other entity. This is not to be confused with a "stand-alone entity" in the meaning of tax law (refer to Chapter 4.5 for details).
Paying agent	A bank of international standing and reputation that has agreed to be responsible for making payments on securities to investors.
Pay-through	A special payment method whereby the payments made by the SV to the investors take place according to a predetermined pattern and maturity, and do not reflect the payback behaviour of the receivables. During the intervening periods, the SV reinvests the receivables, mainly in passive and predefined investments.
Prepayment risk	The possibility that prepayments will be faster than anticipated rates. This can lead to a loss of interest. The SV can pass through the prepaid amounts to investors, thus resulting in earlier payment of principal than expected and reduced income over time. Alternatively, if the SV reinvests the prepayments, the reinvestment's rate of return will be lower than that of the underlying receivables.
Protection buyer	In a transaction such as a credit default swap, the party transferring the credit risk associated with certain assets to another party in return for the payment of what is typically an up-front premium.
Protection seller	In a transaction such as a credit-default swap, the protection seller is the party that accepts the credit risk associated with certain assets. To the extent that losses are incurred on the assets in excess of a specified amount, the protection seller makes credit protection payments to the protection buyer.
Public Interest Entities (PIEs)	Public Interest Entities means: (a) entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State within the meaning of point 21 of Article 4 paragraph 1 of Directive 2014/65/EU; (b) credit institutions as defined in point 12 of Article 1 of the law of 5 April 1993 (as amended) related to financial sector; (c) insurance and reinsurance undertakings as defined under points 5 and 9 of Article 32 paragraph 1 of the Law of 7 December 2015 on insurance sector.
Regulatory arbitrage	The possibility for banks to reduce their regulatory capital requirements of a portfolio of assets without any substantial reduction in the real risks inherent in the assets. For instance, this is the case of a securitisation transaction where the economic risks of the assets securitised have been substantively retained.

Reserve account	A funded account available for use by an SV for one or more specified purposes. A reserve account is often used as a form of credit enhancement.
Residential Mortgage-Backed Securities (RMBS)	RMBS are the most fundamental type of securitisations. These securities involve the issuance of debt, secured by a homogenous pool of mortgage loans that have been secured on residential properties.
Retained interest	Any risks/rewards retained by the originator in a securitisation transaction – for example service fees, any retained interest strip, etc.
Securitisation	A securitisation is a type of structured finance in which a pool of financial assets is transferred to a Securitisation Vehicle which then issues securities solely backed by those assets transferred and the payments derived by those assets.
Senior bonds	Bonds that rank before junior bonds. These bonds or tranches of securities issued by an SV have high or the highest claim against the SV.
Sequential payment structure	A payment structure whereby the cash flow collected by the SV is paid in sequence to the various classes. This means the cash flow is first used for the full payment to the investors of the most senior class, and then for the full payment of the second class, and so on.
Servicer	The entity that collects principal and interest payments from obligors and administers the portfolio after the transaction has closed. It is very common in securitisation transactions for the originators to act as servicers, although this is not always the case. See also "backup servicer".
Special Purpose Vehicle (SPV)	The legal entity established – especially in securitisation transactions – with the purpose of acquiring and holding certain assets for the benefit of investors of the securities issued by the SPV. Therefore, the investors have acquired nothing but the specific assets. The vehicle holds no other assets and has no other obligations. In the context of this brochure, we rather use the term "Securitisation vehicle" (SV) to illustrate that we discuss a SPV involved in a securitisation transaction.
Structural credit enhancement	A type of credit enhancement. It involves creating senior and junior securities, thereby enhancing the credit rating of the senior securities.
Subordination	The technique of subordinating the payment rights of investors and creditors to the prior payment of other securities or debts by the securitisation vehicle.
Synthetic transaction	In a synthetic securitisation transaction, instead of selling an asset pool to the SV, the originator buys protection through a series of credit derivatives. Such transactions do not provide the originator with funding. These transactions are typically undertaken to transfer credit risk and to reduce regulatory-capital requirements.
Synthetic CDO	A CDO-transaction in which the transfer of risk is affected through the use of a credit derivative as opposed to a true sale of the assets.
Tax-transparent entity	An entity that is not subject to tax itself in principle. The shareholders/partners of the entity will be taxed directly.
Third-party credit enhancement	A credit enhancement provided in a securitisation transaction by third-party guarantees, i.e. insurance contracts or a bank letter of credit.
Tranche	A piece, fragment or slice of a deal or structured financing. The risks distributed on different tranches concerning losses, sequential payment of the cash flow, etc. are different. This is why the different tranches is also different.
True-sale	In a true-sale structure, the originator sells a pool of assets to a Securitisation Vehicle, which funds the purchase through the issue of tranches of securities. If the sale is structured in a way that it will be considered as a sale for legal or tax purposes, it is defined as a true-sale.
Trustee	A third party, often a specialist trust corporation or part of a bank, appointed to act on behalf of investors.
Underwriter	Any party that takes on risk. In the context of the capital markets, a securities dealer who commits to purchasing all or part of a securities issuance at a specified price.

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How we can help

We consider one of our roles to be a key driver in promoting a better understanding of the securitisation and structured finance industry, emphasising both the benefits and the potential pitfalls, as well as developing ideas for the future direction of the industry.

To meet this challenge, PwC Luxembourg is part of the Global Structured Finance Group (SFG), which is composed of experts and professionals with extensive knowledge of securitisation and structured finance in all the main jurisdictions around the world. Many PwC professionals across Europe, the US and Asia provide clients with advice, in-depth market insight and pre-eminent transaction support in securitisation and structured finance deals.

We provide services in the following areas:

Audit services

Our global presence allows us to provide all audit services for special purpose entities used for securitisations and structured finance transactions.

Tax strategies and structuring

We can provide tax advice in connection with all aspects of your securitisation, from deal structuring to implementation and monitoring. Through our network of securitisation tax specialists within PwC's global network, we are able to deliver quality tax advice in all major territories. We ensure our clients get answers with respect to tax opinions and tax advice relating to securitisations quickly.

Accounting and regulatory advice

We provide advice on the accounting treatment of securitisation and structured finance structures under IFRS & LuxGAAP and other accounting frameworks. We can help you comply with applicable regulations through regulatory advice and guidance on the latest developments in accounting and regulatory rules and their impact on structures.

Education & training

Provided through PwC's Academy, we run tailored training courses to educate and train clients new to the securitisation and structured finance market.

Your securitisation contacts

Should you have any questions, please do not hesitate to contact us:

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At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 152 countries with over 328,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com and www.pwc.lu.